

Law and Equity in Contract Enforcement

Emily L. Sherwin

Follow this and additional works at: <http://digitalcommons.law.umaryland.edu/mlr>



Part of the [Contracts Commons](#)

Recommended Citation

Emily L. Sherwin, *Law and Equity in Contract Enforcement*, 50 Md. L. Rev. 253 (1991)

Available at: <http://digitalcommons.law.umaryland.edu/mlr/vol50/iss2/6>

This Article is brought to you for free and open access by the Academic Journals at DigitalCommons@UM Carey Law. It has been accepted for inclusion in Maryland Law Review by an authorized administrator of DigitalCommons@UM Carey Law. For more information, please contact smccarty@law.umaryland.edu.

Articles

LAW AND EQUITY IN CONTRACT ENFORCEMENT

EMILY L. SHERWIN*

TABLE OF CONTENTS

INTRODUCTION: A DESCRIPTION OF THE PROBLEM	253
I. VALUES RELATED TO LEGAL AND EQUITABLE STANDARDS OF CONTRACT ENFORCEMENT	264
A. <i>Legal Defenses</i>	265
B. <i>Equity: The Fairness Defense</i>	273
II. WHY IS THERE A DOUBLE STANDARD?	276
A. <i>Specific and Substitutional Relief</i>	276
1. <i>External Effects of Specific Relief</i>	277
2. <i>Efficiency</i>	278
3. <i>Distributive Effects</i>	280
4. <i>Relational Considerations</i>	285
B. <i>Equitable Defenses as a Means of Compromise</i>	286
1. <i>The Bargain Principle</i>	287
2. <i>Limits on the Bargain Principle</i>	293
3. <i>Is an Equitable Fairness Defense the Right Solution?</i> ..	299
C. <i>Acoustic Separation</i>	300
1. <i>The Concept of Acoustic Separation</i>	301
2. <i>Acoustic Separation Applied to Contract Enforcement</i> ..	306
3. <i>Is Acoustic Separation Acceptable?</i>	308
CONCLUSION	314

INTRODUCTION: A DESCRIPTION OF THE PROBLEM

According to traditional doctrine, a contract plaintiff is entitled to legal damage remedies for breach of contract unless the defendant establishes a distinct defense such as fraud.¹ But the equitable

* Professor of Law, University of San Diego. J.D. Boston University, 1981. I would like to thank Victoria Biedebach and Dinyar Mehta for valuable research assistance. Thanks also to Larry Alexander, Gail Heriot, Douglas Laycock, Gerald Postema, Maimon Schwarzschild, Sarah Welling and Chris Wonnell for helpful comments on this Article.

1. The defense of unconscionability is an exception to this statement. *See infra* notes 56-57 and accompanying text. Through most of this Article, I will confine my discussion of legal defenses against contract enforcement to traditional defenses such as

remedy of specific performance is not available unless the contract is *fair*. In the following pages, I will consider why this is so.

Traditionally, the remedy of specific performance has been subject to an extra layer of defenses that do not apply to legal contract remedies.² Some defenses to specific performance are based on the practical difficulties of administering specific relief.³ But another type of equitable defense, which I will call a fairness defense, rests on moral standards that have no obvious relation to the mechanics of the remedy. Equity is said to operate on a higher moral plane than law: it demands more meticulous conduct and a greater degree of altruism between contracting parties, and it will not assist one party in taking unfair advantage of the other.⁴ As a result, a court

fraud and mistake, as if the defense of unconscionability did not exist. I hope that by doing this, I will be able in the end to cast some light on unconscionability.

2. The second *Restatement of Contracts* sets out a catalogue of defenses to specific performance in §§ 359-68. RESTATEMENT (SECOND) OF CONTRACTS §§ 359-68 (1981). Another helpful survey appears in E. YORIO, CONTRACT ENFORCEMENT: SPECIFIC PERFORMANCE AND INJUNCTIONS 101-26 (1989). Professor Yorio defends the existence of special defenses to equitable relief, primarily because the combination of equitable defenses and defects in the damage remedy allows courts to reach a compromise between competing interests. *Id.* §§ 4.5.2, 4.6. I propose a similar interpretation of equitable defenses in subpart II(B) *infra*, but I do not think separate defenses to equitable relief are an effective means of refining contract remedies.

3. Examples are difficulty of supervision and the related requirement of certainty in the terms of the contract. *See* D. DOBBS, HANDBOOK ON THE LAW OF REMEDIES 62-65 (1973); D. LAYCOCK, MODERN AMERICAN REMEDIES: CASES AND MATERIALS 389-90, 777-81 (1985); RESTATEMENT (SECOND) OF CONTRACTS §§ 362, 366 (1981); E. YORIO, *supra* note 2, at 45-72.

4. *See* Kelly v. Central Pac. R.R., 74 Cal. 557, 562, 16 P. 386, 389 (1888) (in granting equitable relief, the court can "give greater effect to the principles of morality than can be done in ordinary cases"); Lannon v. Lamps, 53 Ill. App. 3d 145, 148, 368 N.E.2d 196, 198 (1977) (contract must be "just, reasonable and free from misapprehension or misrepresentation"), *aff'd*, 80 Ill. App. 3d 318, 399 N.E.2d 712 (1980); Schlegel v. Moorhead, 170 Mont. 391, 397, 553 P.2d 1009, 1012 (1976) (plaintiff must present "a cause whose ethical qualities . . . commend it to the conscience of the chancellor" (quoting Interior Secs. Co. v. Campbell, 55 Mont. 459, 470, 178 P. 582, 585 (1919))); Pecorella v. Greater Buffalo Press, Inc., 107 A.D.2d 1064, 1065, 486 N.Y.S.2d 562, 563 (1985) (plaintiff must have clean hands); J. CALAMARI & J. PERILLO, THE LAW OF CONTRACTS § 16-14, at 677 (3d ed. 1987); Z. CHAFEE, SOME PROBLEMS OF EQUITY 28-32 (1950); 5A A. CORBIN, CONTRACTS § 1162, at 207 (1964); D. DOBBS, *supra* note 3, § 2.4, at 45, 55-56 (criticizing stricter ethical standards for equitable relief); E. FRY, SPECIFIC PERFORMANCE OF CONTRACTS § 387 (6th ed. 1921) ("equality and fairness . . . are essential in order that the Court may exercise its extraordinary jurisdiction in specific performance"); 1 J. POMEROY, EQUITY JURISPRUDENCE §§ 43-67 (5th ed. 1941) (tracing the influence of moral precepts on equity jurisprudence, but distinguishing between equity and morality); 1 J. STORY, COMMENTARIES ON EQUITY JURISPRUDENCE § 206, at 229 (13th ed. 1886) ("principles of ethics have a more extensive sway" in equity (quoting 2 J. KENT, COMMENTARIES ON AMERICAN LAW 490 (1927))); E. YORIO, *supra* note 2, § 1.3, at 11, § 4.4.1, at 87; Dawson, *Specific Performance in France and Germany*, 57 MICH. L. REV. 495, 523, 535-36 (1959) (criticizing a double standard); Farnsworth, *Legal Remedies for Breach of Contract*, 70

may deny specific performance on the basis of "hardship," or "sharp practice," although the defect in the transaction is not concrete enough to establish a defense at law.⁵

*Panco v. Rogers*⁶ is a good example. An elderly couple (the Pancos) signed an agreement to sell their home to the Rogers for \$5500.⁷ The court valued the property at \$10,000.⁸ Mr. Panco, an elderly carpenter, was hard of hearing and lacked business experience; Mrs. Panco was "of foreign extraction" and may not have been fluent in English.⁹ The Pancos thought the price in the contract was

COLUM. L. REV. 1145, 1155-56 (1970) (same); Leff, *Unconscionability and the Code—The Emperor's New Clause*, 115 U. PA. L. REV. 485, 530-33 (1967) (distinguishing between unconscionability in equity and unconscionability in the Uniform Commercial Code); Newman, *The Place and Function of Pure Equity in the Structure of Law*, 16 HASTINGS L.J. 401, 404-05 (1965) (criticizing a double standard).

5. See *McAllister v. Schettler*, 521 A.2d 617, 623 (Del. Ch. 1986) ("Factors such as weakened mental condition in one party, undue influence and unfairness in the contract terms, although not of a sufficient degree to avoid the contract . . . will justify denial of specific performance."), *aff'd* 547 A.2d 634 (Del. 1988); *Lannon v. Lamps*, 80 Ill. App. 3d 318, 324-26, 399 N.E.2d 712, 716-18 (1980) (unequal bargaining power); *Hilton v. Nelsen*, 283 N.W.2d 877, 881-83 (Minn. 1979) (unfairness or overreaching); *Best v. Culhane*, 677 S.W.2d 390, 394-95 (Mo. Ct. App. 1984) (treating the defense as an equitable defense, though there may have been grounds for rescission as well); *Schlegel v. Moorhead*, 170 Mont. 391, 394-97, 553 P.2d 1009, 1011-12 (1976) (concealment and circumvention); *Panco v. Rogers*, 19 N.J. Super. 12, 19-20, 87 A.2d 770, 773-74 (Ch. Div. 1952) (unilateral mistake, inadequacy of price, and general unfairness); *Castaldi v. Multer*, 117 A.D.2d 699, 700, 498 N.Y.S.2d 438, 439 (1986); *Pecorella v. Greater Buffalo Press, Inc.*, 107 A.D.2d 1064, 1065, 486 N.Y.S.2d 562, 563 (1985) (any willful conduct that would be "condemned" by fair-minded people is sufficient to deny specific relief); *Smith v. Ferguson*, 622 P.2d 1086, 1087 (Okla. App. 1981); *In re Estate of Mihm*, 345 Pa. Super. 1, 4-5, 7-10, 497 A.2d 612, 613, 615-16 (1985) (indicating at times that the contract might be subject to rescission); *Hodge v. Shea*, 252 S.C. 607, 168 S.E.2d 82 (1969) (treating the defense as an equitable defense, though there may have been grounds for rescission as well); *McKinnon v. Benedict*, 38 Wis. 2d 607, 616-23, 157 N.W.2d 665, 669-72 (1968) (failing to meet "the test of reasonableness that is the *sine qua non* of the enforcement of rights in an action in equity"); *Patel v. Ali*, [1984] 1 Ch. 283, 286-88; RESTATEMENT (SECOND) OF CONTRACTS § 364 & comment a (1981); J. CALAMARI & J. PERILLO, *supra* note 4, at 677-79; G. CLARK, PRINCIPLES OF EQUITY § 156, at 230-31 (1954); 5A A. CORBIN, *supra* note 4, § 1162, at 205-07; D. DOBBS, *supra* note 3, at 45, 47-49, 705-06; E. FRY, *supra* note 4, §§ 44, 417, 652, 752; H. MCCLINTOCK, PRINCIPLES OF EQUITY §§ 69-74 (2d ed. 1948); J. POMEROY, SPECIFIC PERFORMANCE OF CONTRACTS § 40 (3d ed. 1926); 2 J. STORY, *supra* note 4, §§ 750, 769; W. WALSH, EQUITY §§ 103-04 (1930); 11 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS §§ 1425, 1426-28 (3d ed. 1968); E. YORIO, *supra* note 2, ch. 4.

For an entertaining catalogue of suspicious circumstances and "presumptive sillies" likely to appear in equitable defense cases, see Leff, *supra* note 4, at 531-33. Professor Leff said that "as a rough guess . . . there are as many cases dealing with denials of specific performance as stars in the heavens or sand by the sea." *Id.* at 530.

6. 19 N.J. Super. 12, 87 A.2d 770 (Ch. Div. 1952).

7. *Id.* at 15, 87 A.2d at 771.

8. *Id.* at 16, 87 A.2d at 772.

9. *Id.* at 15-16, 87 A.2d at 771-72.

\$12,500, but they signed without discovering their error.¹⁰ The Rogers did nothing palpably wrong and believed the price asked was \$5500, as stated in the written agreement.¹¹ The court found no basis to set aside the contract; at most there was a unilateral mistake by the Pancos and no concrete evidence that the Rogers were aware of the mistake.¹² Nevertheless, it denied specific performance.¹³ It explained that before granting an equitable remedy, "the court must be satisfied that the claim is fair, reasonable and equal in all its parts."¹⁴ If enforcement of the contract would be "harsh, oppressive or manifestly unjust" to the promisor, the equitable remedy should be withheld.¹⁵

It is difficult to describe the content of the fairness defense because the defense is very fluid. Typically, the decision to deny specific performance is based on a combination of one party's mistake or lack of sophistication, unverified suspicions that the other was aware of her advantage, and an unequal exchange of value.¹⁶ In particular cases, one or another element may predominate; the court may be moved by hardships that arose after the contract was made,¹⁷ the promisor's disabilities at the time of negotiation,¹⁸ the

10. *Id.* at 16, 87 A.2d at 772.

11. *Id.*

12. *See id.* at 17, 87 A.2d at 773. The purchase and sale agreement was drawn by the Rogers lawyer and signed at his office. But the court found there was no "actual fraud, undue influence or concealment" by the Rogers, and therefore no grounds for rescission. *Id.* at 18, 87 A.2d at 773.

13. *See id.* at 21, 87 A.2d at 774.

14. *Id.* at 19-20, 87 A.2d at 773.

15. *Id.* at 19, 87 A.2d at 773.

16. *E.g.*, *McAllister v. Schettler*, 521 A.2d 617, 623-24 (Del. Ch. 1986) (an unsophisticated seller in a weakened mental condition, an inadequate and possibly misleading explanation of the contract, and a low price), *aff'd*, 547 A.2d 634 (Del. 1988); *Hilton v. Nelsen*, 283 N.W.2d 877, 881-83 (Minn. 1979) (a combination of circumstances, including misunderstandings by the seller and one-sided financing terms); *Schlegel v. Moorhead*, 170 Mont. 341, 392-97, 552 P.2d 1009, 1010-12 (1976) (a buyer's failure to disclose information and a low price); *Panco*, 19 N.J. Super. at 21, 87 A.2d at 774 (an elderly and unsophisticated seller, a unilateral mistake about the price, a contract prepared by the buyer, and a low price); *In re Estate of Mihm*, 345 Pa. Super. 1, 5-10, 497 A.2d 612, 614-16 (1985) (a confidential relation between two brothers and their sister and a low price); *Hodge v. Shea*, 252 S.C. 601, 606-13, 168 S.E.2d 82, 84-87 (1969) (an alcoholic seller lured by the promise of a new Cadillac, and a low price); *McKinnon v. Benedict*, 38 Wis. 2d 607, 613-14, 619-22, 157 N.W.2d 665, 667-68, 670-72 (1968) (a promisor in financial straits and a low price). *See* RESTATEMENT (SECOND) OF CONTRACTS § 365 comment a (1979); 5A A. CORBIN, *supra* note 4, § 1162, at 207 (usually a combination of circumstances); E. FRY, *supra* note 4, § 99 (same); H. MCCLINTOCK, *supra* note 5, § 69, at 188. *Cf.* E. YORIO, *supra* note 2, § 5.4, at 105-06 (categorizing equitable defenses but acknowledging that "the distinction in theory . . . breaks down in practice").

17. *E.g.*, *Patel v. Ali*, [1984] 1 Ch. 283 (enormous unforeseen personal difficulties).

18. *E.g.*, *Panco*, 19 N.J. Super. at 16, 87 A.2d at 772 (unilateral mistake).

promisee's disposition to take advantage,¹⁹ or the discrepancy in values exchanged.²⁰

One feature that characterizes all versions of the fairness defense is their indeterminacy.²¹ Traditional legal defenses to contract enforcement, such as fraud, mistake, or incapacity, are relatively well defined.²² The fairness defense is an open-ended

19. *E.g.*, *Hodge v. Shea*, 252 S.C. 601, 168 S.E.2d 82 (1969) (enticing a drunk with a Cadillac).

20. *E.g.*, *In re Estate of Mihm*, 345 Pa. Super. 1, 497 A.2d 612 (1985) (sale of stock in a family corporation for a very low price). There is a longstanding debate on the question whether inadequate consideration, without more, is enough to support a defense to specific performance. The two sides divide roughly into those who say a court should not specifically enforce an unequal exchange, and those who say specific performance is proper unless the discrepancy in value is so great as to be "conclusive evidence of fraud." See, *e.g.*, *Seymour v. Delancey*, 3 Cow. 445, 521-22 (N.Y. 1824); J. CALAMARI & J. PERILLO, *supra* note 4, § 16-14, at 678; 5A A. CORBIN, *supra* note 4, § 1165, at 22-38; W. WALSH, *supra* note 5, § 104, at 1428; 11 S. WILLISTON, *supra* note 5, § 1428; E. YORIO, *supra* note 2, § 5.4.3. These two positions may not be far apart in practice, but they differ in theory. One side proposes that courts can and should evaluate the substantive terms of a private exchange, while the other implies that courts are not competent to engage in substantive review and should limit their inquiry to the process by which the agreement was reached. Compare Epstein, *Unconscionability: A Critical Reappraisal*, 18 J. L. & ECON. 293, 305-06 (1975) (opposing substantive review) with Gordley, *Equality in Exchange*, 69 CALIF. L. REV. 1587 (1981) (in favor of substantive review).

21. When the various components of a fairness defense are disentangled and considered separately, they raise very different issues. On unanticipated hardship, see, *e.g.*, Harrison, *A Case for Loss Sharing*, 56 S. CAL. L. REV. 573 (1983) (contract as joint enterprise); Posner & Rosenfield, *Impossibility and Related Doctrines in Contract Law: An Economic Analysis*, 6 J. LEGAL STUD. 83 (1977) (relative abilities of the parties to prevent or insure against risk). On the integrity of the bargaining process, see, *e.g.*, Dawson, *Economic Duress—An Essay in Perspective*, 45 MICH. L. REV. 253, 282-90 (1947) (advantages gained through unequal bargaining power as unjust enrichment); Eisenberg, *The Bargain Principle and Its Limits*, 95 HARV. L. REV. 741, 754-85 (1982) (four "norms of unconscionability"); Epstein, *supra* note 20, at 301-05 (opposing interference with bargaining power); Kronman, *Paternalism and the Law of Contracts*, 92 YALE L.J. 763 (1983) [hereinafter Kronman, *Paternalism*] (distortions in private choice); Sunstein, *Legal Interference with Private Preferences*, 53 U. CHI. L. REV. 1129, 1169-73 (1986) (same). On inequality of values exchanged, see, *e.g.*, Epstein, *supra* note 20, at 305-06; Gordley, *supra* note 20. On non-disclosure and palpable mistake, see, *e.g.*, Kronman, *Mistake, Disclosure, Information, and the Law of Contracts*, 7 J. LEGAL STUD. 1, 9-32 (1978) [hereinafter Kronman, *Mistake*] (incentives for production of information); Levmore, *Securities and Secrets: Insider Trading and the Law of Contracts*, 68 VA. L. REV. 117 (1982); Wonnell, *The Structure of a General Theory of Nondisclosure*, 41 CASE W. RES. L. REV. (forthcoming 1991) (uniting information with resources). A fairness defense, however, depends on the cumulative effect of several or all of these factors. In this Article, I have chosen to combine them under the single heading of fairness and address their common features rather than their differences.

22. See *infra* notes 48-54 and accompanying text. Most of the standard defenses to contract enforcement developed first in equity, as reasons why the chancellor might enjoin the promisee from prosecuting a claim in the law courts. Over time they became defenses at law as well. See generally H. MCCLINTOCK, *supra* note 5, § 79, at 214-15 (fraud); 2 G. PALMER, *THE LAW OF RESTITUTION* § 12.6(b), at 585-87 (1978); 3 J. POME-

standard that reaches an additional level of unfairness outside the categories recognized at law.²³ Its lack of definition invites the judge to respond in a more particularistic way to the facts of each case.

The fairness defense is equitable in the sense that it applies only to the equitable remedy of specific performance, and does not disturb the underlying contract obligation. A promisor who establishes a defense of fraud is entitled to a decree of rescission, which nullifies the contract.²⁴ In contrast, a less concrete claim of unfair-

ROY, *supra* note 4, § 838, at 282 (mistake); W. WALSH, *supra* note 5, § 35, at 31 (fraud and mistake), § 106, at 496 (fraud).

23. The unconscionability provisions of the Uniform Commercial Code and the second *Restatement* have introduced a legal defense that resembles the equitable fairness defense, at least according to some interpretations. See U.C.C. § 2-302 (1977); *RESTATEMENT (SECOND) OF CONTRACTS* § 208 (1981). There is no consensus on the meaning of unconscionability under the U.C.C., and it may not reach all cases in which a court would deny specific performance on grounds of fairness. Compare E. FARNSWORTH, *CONTRACTS* § 4.28, at 328 (1990); E. YORIO, *supra* note 2, § 5.4.1, at 107-08; Leff, *supra* note 4, at 528-41; and Schwartz, *The Case for Specific Performance*, 89 *YALE L.J.* 271, 299 (1979) [hereinafter Schwartz, *Specific Performance*] (all suggesting that unconscionability in equity is broader than unconscionability at law); with Hillman, *Debunking Some Myths About Unconscionability: A New Framework for U.C.C. Section 2-302*, 67 *CORNELL L. REV.* 1, 35-41 (1981) (unconscionability in equity can and should inform application of U.C.C. § 2-302) and Newman, *The Renaissance of Good Faith in Contracting in Anglo-American Law*, 54 *CORNELL L. REV.* 553, 561 (1969) (U.C.C. § 2-302 incorporates "the equitable criterion of fairness"). For relatively broad interpretations of unconscionability under the U.C.C., see, e.g., J. CALAMARI & J. PERILLO, *supra* note 4, § 9-38, at 402, § 9-40, at 406; J. WHITE & J. SUMMERS, *UNIFORM COMMERCIAL CODE* § 4.7 (3d ed. 1988); Ellinghaus, *In Defense of Unconscionability*, 78 *YALE L.J.* 757 (1969). For narrower interpretations, see, e.g., Epstein, *supra* note 20; Murray, *Unconscionability: Unconscionability*, 31 *U. PITT. L. REV.* 1 (1969). See also Eisenberg, *supra* note 21, at 748-85 (1982) (norms of unconscionability designed to reflect failure of the justifications for full enforcement of bargains); Schwartz, *A Reexamination of Nonsubstantive Unconscionability*, 63 *VA. L. REV.* 1053 (1977) [hereinafter Schwartz, *Nonsubstantive Unconscionability*] (criticizing several applications of procedural unconscionability). Further, unconscionability as a legal defense has evolved mainly in the context of sales of goods, where it addresses a special type of problem. Unconscionability in sales of goods is likely to be oppression on a mass scale, carried out through printed forms, rather than advantage-taking between individuals. See Leff, *supra* note 4, at 537 ("Equity dealt with the pathology of bargaining. The Code deals with the pathology of nonbargaining.").

24. See 3 H. BLACK, *RESCISSIION OF CONTRACTS AND CANCELLATION OF WRITTEN INSTRUMENTS* § 704 (2d ed. 1929); G. CLARK, *supra* note 5, § 278, at 408 & n.6; D. DOBBS, *supra* note 3, at 254-55, 294-96, 618; H. MCCLINTOCK, *supra* note 5, § 84 (fraud), § 94 (mistake); 1 G. PALMER, *supra* note 22, § 3.3, at 236, § 3.13, at 308-09 (fraud); 2 *id.* § 12.6(a) (mistake in assumption). When a contract is rescinded, the court's remedial object is to restore the parties to their previous positions as if the contract had never existed. Usually this means both parties are entitled to restitution of any benefit conferred through partial performance. See *RESTATEMENT (SECOND) OF CONTRACTS* § 376 & comment a (1981) (incapacity, mistake, misrepresentation, duress, undue influence, breach of fiduciary relation), § 377 & comment a (impracticability, frustration); 3 H. BLACK, *supra*, §§ 74, 616; G. CLARK, *supra* note 5, § 294, at 425; D. DOBBS, *supra* note 3, at

ness ordinarily does not support rescission, although it may persuade the court to deny specific performance.²⁵ When a court follows this pattern—refusing the promisee's claim for specific performance but also refusing the promisor's claim for rescission—the contract remains in place. As a result, the promisee can sue for damages for breach, measured by the lost value of her bargain.²⁶ Equitable enforcement is barred, but a legal damage remedy is not.

The special treatment of equitable relief is highlighted by the procedural merger of law and equity. Almost everywhere, law and equity are now administered in a single court. When a merged court recognizes a fairness defense to specific performance, one judge is applying two different standards of morality, depending on

254-55; 2 G. PALMER, *supra* note 22, § 12.6(a), at 583-84 (mistake). On protection of the promisee's reliance interest, see *infra* notes 154-159 and accompanying text.

In addition to seeking a decree of rescission, the promisor can assert her right to rescind indirectly, by raising the fraud as a defense to a damage claim by the promisee. See D. DOBBS, *supra* note 3, at 255, 292-94; 2 G. PALMER, *supra* note 22, § 12.6(a), at 583-84 (mistake). Rescission began as an equitable remedy, carried out by means of an injunction against enforcement of the contract at law. Over time the same defenses that supported rescission in equity were recognized by the law courts. As a result the promisor could achieve the effect of a rescission decree by tendering restitution to the promisee. Once she had tendered restitution, she could defend against the promisee's damage claim, or bring her own quasi-contract action to recover benefits conferred on the promisee. The tender requirement is now obsolescent. For a fuller explanation, see D. DOBBS, *supra* note 3, at 292-96.

25. *E.g.*, *McAllister v. Schettler*, 521 A.2d 617, 623 (Del. Ch. 1986), *aff'd*, 547 A.2d 634 (Del. 1988); *Schlegel v. Moorhead*, 170 Mont. 391, 394-95, 553 P.2d 1009, 1011 (1976); *Panco v. Rogers*, 19 N.J. Super. 12, 18, 21, 87 A.2d 770, 773, 774 (Ch. Div. 1952); *Smith v. Ferguson*, 622 P.2d 186, 187 (Okla. App. 1981); *In re Estate of Mihm*, 345 Pa. Super. 1, 3-4, 497 A.2d 612, 613 (1985); J. CALAMARI & J. PERILLO, *supra* note 4, § 16-17; G. CLARK, *supra* note 5, § 156, at 230-31, § 280, at 409, § 161, at 238-39, § 168, at 247-49; 5A A. CORBIN, *supra* note 4, § 1162, at 205, § 1164, at 219-20; H. MCCLINTOCK, *supra* note 5, § 69, at 188-89, § 72, at 196-97; W. WALSH, *supra* note 5, § 103, at 477, 479, § 104 at 481; 11 S. WILLISTON, *supra* note 5, § 1425, at 827, § 1426, at 853, § 1427, at 857-58; E. YORIO, *supra* note 2, § 1.3, at 12, § 4.5.1, at 91-93 & n.4.

26. *E.g.*, *Hilton v. Nelsen*, 283 N.W.2d 877, 883-84 & n.5 (Minn. 1979); *Pecorella v. Greater Buffalo Press, Inc.*, 107 A.D.2d 1064, 1065, 486 N.Y.S.2d 562, 563 (1985); *McKinnon v. Benedict*, 38 Wis. 2d 607, 618-19, 157 N.W.2d 665, 670 (1968); *Patel v. Ali*, [1984] 1 Ch. 283, 288-89; J. CALAMARI & J. PERILLO, *supra* note 4, § 16-17; G. CLARK, *supra* note 5, § 156, at 230-31, § 280, at 409; 5A A. CORBIN, *supra* note 4, § 1164, at 220-21; D. DOBBS, *supra* note 3, at 48; E. YORIO, *supra* note 2, § 1.3, at 12, § 4.1, at 74, § 4.2, at 76-79, § 4.5.1, at 91-93. One empirical study suggests that in fact promisees seldom go on to recover damages after losing on a claim for specific performance. Frank & Endicott, *Defenses in Equity and "Legal Rights"*, 14 LA. L. REV. 380, 381 (1954) (plaintiff recovered damages in 2 of 150 cases surveyed). The authors attribute this pattern to the expansion of legal defenses, limitations on the damage remedy, and plaintiffs' exhaustion. *Id.* at 381-83, 386-89. Their results may also reflect procedural obstacles that have since been eliminated by liberal rules on amendment of pleadings. See *id.* at 384.

the remedy sought.²⁷

This double standard is hard to understand. At least in theory, specific performance and damages are simply two means of accomplishing the same result. Specific performance protects the plaintiff's expectation interest in a contract by delivering the promised performance. The standard measure of damages for breach of contract protects the same interest, forcing the defendant to pay the monetary equivalent of the promised performance.²⁸ Why, then, do courts apply (or claim to apply) a different standard to specific performance?

The double standard of morality for legal and equitable contract remedies has been the subject of some scathing criticism in scholarly writing.²⁹ Courts, too, seem less enthusiastic than they

27. Others have made this point. *E.g.*, Z. CHAFEE, *supra* note 4, at 28.

28. RESTATEMENT (SECOND) OF CONTRACTS § 344(a) & comment a, § 347 & comment a (1979); J. CALAMARI & J. PERILLO, *supra* note 4, § 14-4; 5A A. CORBIN, *supra* note 4, § 992; 11 S. WILLISTON, *supra* note 5, § 1338, at 198; Farnsworth, *supra* note 4, at 1147-49. Various limits on expectancy damages are discussed *infra* in text accompanying notes 160-171.

There is much literature on the expectancy measure and its justifications. Some examples are P. ATIYAH, PROMISES, MORALS AND LAW 41-42 (1981) [hereinafter P. ATIYAH, PROMISES] (finding no persuasive justification for an expectancy measure and preferring to focus on reliance and unjust enrichment); P. ATIYAH, THE RISE AND FALL OF FREEDOM OF CONTRACT 1-7 (1979) [hereinafter P. ATIYAH, FREEDOM OF CONTRACT] (same); C. FRIED, CONTRACT AS PROMISE 17-19 (1981) (expectancy damages as a corollary of a view of contract obligation in which promises derive moral force from the principle of autonomy); A. POLINSKY, AN INTRODUCTION TO LAW AND ECONOMICS 31-38, 59-65 (2d ed. 1989) (evaluating expectancy damages in light of three economic objectives: efficient breach, efficient reliance, and efficient risk allocation); Cooter & Eisenberg, *Damages for Breach of Contract*, 73 CALIF. L. REV. 1434, 1459-77 (1985) (defending the expectancy measure, to the extent that it is the remedy the parties would have bargained for under ideal conditions); Eisenberg, *supra* note 23 (identifying reasons of fairness and efficiency in support of the bargain principle and situations in which those reasons falter); Fuller & Perdue, *The Reliance Interest in Contract Damages* (pt. 1), 46 YALE L.J. 54, 57-66 (1936) (expectancy damages as a means of protecting against and compensating reliance loss); Goetz & Scott, *Enforcing Promises: An Examination of the Basis of Contract*, 89 YALE L.J. 1261, 1281-88 (1980) [hereinafter Goetz & Scott, *Basis of Contract*] (expectancy damages as a surrogate for an ideal net reliance remedy designed to produce an optimal level of promissory activity); Goetz & Scott, *Liquidated Damages, Penalties and the Just Compensation Principle: Some Notes on an Enforcement Model and a Theory of Efficient Breach*, 77 COLUM. L. REV. 554, 558-78 (1977) [hereinafter Goetz & Scott, *Efficient Breach*] (expectancy damages explained in terms of efficient breach); Wolcher, *The Accommodation of Regret in Contract Remedies*, 73 IOWA L. REV. 797, 804-14, 867-75, 891-92 (1988) (favoring a mix of remedies that acknowledges the uncertainty of contractual choices).

29. See Z. CHAFEE, *supra* note 4, at 28-32; Dawson, *supra* note 4, at 535-36; Farnsworth, *supra* note 4, at 1156; Newman, *supra* note 4, at 404-05, 426-29; Newman, *supra* note 23, at 564-65; Patterson, *Equitable Relief for Unilateral Mistake*, 28 COLUM. L. REV. 859, 899-900 (1928); Schwartz, *Specific Performance*, *supra* note 23, at 298-303. See also Laycock, *The Death of the Irreparable Injury Rule*, 103 HARV. L. REV. 687, 692-93 (1990)

once were about the special moral status of specific performance. There are few reported decisions in recent years in which courts have denied specific performance and also refused rescission or granted damages.³⁰ Yet courts continue to say there is a distinction in the moral standards applicable to legal and equitable relief; opinions repeatedly assert that specific performance is discretionary and may be withheld on the basis of unfairness that would not affect a damage remedy.³¹ The second *Restatement* also preserves the special standard for equitable relief in unquestioning terms.³²

The purpose of this Article is to consider whether there is any coherent explanation or justification for a morally inspired defense that is uniquely applicable to specific enforcement of contracts. Is there anything about the equitable remedy that calls for a stricter standard of behavior, or a greater degree of altruism between par-

(concluding that stricter standards for equitable remedies are obsolete except as they relate to functional differences between specific and substitutional relief). *But cf.* D. DOBBS, *supra* note 3, at 48-49 (suggesting that by means of an equitable defense, courts may be able to influence future action without upsetting existing bargains); H. McCLINTOCK, *supra* note 5, § 69, at 189 (favoring "an intermediate zone" between specific performance and rescission); E. YORIO, *supra* note 2, § 4.5.2 (defending equitable defenses because they minimize the use of coercive remedies and allow courts to reach an intermediate solution in weak cases).

30. I found six such cases dated after 1970. *McAllister v. Schettler*, 521 A.2d 617, 623 (Del. Ch. 1986) (land sale contract); *Hilton v. Nelsen*, 283 N.W.2d 877, 883-84 & n.5 (Minn. 1979) (land sale contract); *Schlegel v. Moorhead*, 170 Mont. 391, 397, 553 P.2d 1009, 1011 (1976) (option to purchase a federal oil and gas lease); *Pecorella v. Greater Buffalo Press, Inc.*, 107 A.D.2d 1064, 1065, 486 N.Y.S.2d 562, 563 (1985) (land sale contract); *Smith v. Ferguson*, 622 P.2d 1086, 1087 (Okla. Ct. App. 1981) (land sale contract); *Patel v. Ali*, [1984] 1 Ch. 283, 288-89 (land sale contract). *See also* *Castaldi v. Multer*, 117 A.D.2d 699, 700, 498 N.Y.S.2d 438, 439 (1986) (damages denied in land sale contract for lack of proof).

It is difficult to verify current practice, however, because the cost of modern litigation makes it unlikely that cases of this type will reach the appellate level.

31. *E.g.*, *Kakalik v. Bernardo*, 184 Conn. 386, 391, 439 A.2d 1016, 1020-21 (1981); *Mearida v. Murphy*, 106 Ill. App. 3d 705, 709-10, 435 N.E.2d 1352, 1355 (1982); *Lannon v. Lamps*, 80 Ill. App. 3d 318, 323-24, 399 N.E.2d 712, 716 (1980); *Youngblut v. Wilson*, 294 N.W.2d 813, 817 (Iowa 1980); *Baumann v. Nutter*, 328 N.W.2d 354, 356 (Iowa Ct. App. 1982); *Best v. Culhane*, 677 S.W.2d 390, 394-95 (Mo. Ct. App. 1984); *In re Estate of Mihm*, 345 Pa. Super. 1, 4-5, 497 A.2d 612, 613-14 (1985); *Amick v. Hagler*, 286 S.C. 481, 484, 334 S.E.2d 525, 527 (1985); *King v. Oxford*, 282 S.C. 307, 314, 318 S.E.2d 125, 129 (1984). *See* J. CALAMARI & J. PERILLO, *supra* note 4, §§ 16-7, 17-14; E. YORIO, *supra* note 2, § 4.5.1, at 91-92.

32. *See* RESTATEMENT (SECOND) OF CONTRACTS § 364 (1981). Section 364(1) states that specific performance should be denied if enforcement is unfair by reason of mistake, sharp practice, unreasonable hardship, grossly inadequate consideration, or unfair terms. The comment adds that "the discretionary nature of equitable relief permits its denial when a variety of factors combine to make enforcement of a promise unfair, even though no single legal doctrine alone would make the promise unenforceable." *Id.* comment a.

ties? Is there any other reason, apart from the nature of the legal and equitable remedies, why courts preserve a distinction in the defenses available?

My analysis begins in Part I by identifying different values represented by legal and equitable standards for enforcement of contracts. Legal and equitable defenses correspond to opposing theories of contract obligation. They also follow different formal approaches to law.

In Part II, I consider three ways of explaining the persistence of a dual standard. First, there are some real differences in the operation of specific and substitutional relief as a means of protecting contract expectations.³³ In certain situations, specific performance and damages have different effects on the interests of third parties, on efficiency in resource allocation, and on the distribution of wealth between the parties. These effects, however, are not present in all cases, and so do not justify a generally applicable fairness defense to equitable relief.

Second, courts may use the fairness defense to achieve a compromise remedy when they sense that protection of the promisee's expectations is not appropriate.³⁴ The compromise is possible because, although contract damages are supposed to protect the promisee's expectations, they often fall short of this objective. In many cases, especially those that fall within the traditional scope of the specific performance remedy, doctrinal limits and practical difficulties of proof prevent the promisee from recovering the economic equivalent of her bargain through a legal damage remedy. As a result, a fairness defense to specific performance tends to undermine the expectancy measure and push the remedy toward reliance, without altogether extinguishing the promisor's liability. If this is the function of the fairness defense, however, a more direct solution is needed.³⁵

33. See *infra* subpart II(A).

34. See *infra* subpart II(B).

35. Professor Douglas Laycock makes a similar point in his analysis of irreparable injury as a limit on equitable relief. Laycock, *supra* note 29, at 692-93, 726-28, 765-71. His study shows that courts use the terms "irreparable injury" and "adequate remedy at law" to accomplish a variety of particular goals that have no relation to the legal or equitable origin of the remedy. *Id.* at 692. For example, courts may balance the hardship a specific remedy will impose on the defendant against the hardship the plaintiff will suffer if the remedy is denied. But this is a comparison of costs and benefits of the two remedies, rather than a preference for legal relief. *Id.* at 749-52. Laycock concludes that the irreparable injury rule should be discarded in favor of a more direct analysis of the functional effects of different remedies. See *id.* at 768-71.

My first two explanations of the fairness defense follow along similar lines. See *infra*

A third possible explanation of the separate standards for legal and equitable enforcement of contracts is that courts have used the equitable fairness defense as a device to resolve a persistent conflict between the utilitarian benefits of stability in contract law and the impulse to impose altruist values in particular cases.³⁶ The institution of private exchange requires a legal foundation with the appearance of security for future transactions. A nebulous defense to contract liability that cannot be captured in a rule undermines that foundation. But the utility of contract law is a function of the message judicial decisions send to the market, rather than the decisions themselves. When the courts' power to give relief on the basis of fairness is wrapped in the obscure form of an equitable defense, there may be a sufficient degree of "acoustic separation"³⁷ to preserve the appearance that contracts are reliable. In other words, the court may be able to accomplish both goals (stability and altruism) at once. This may in fact work quite well. But is it acceptable?

My analysis of these issues is framed against the background of existing limitations on the scope of the specific performance remedy. Prevailing doctrine holds that specific performance is available only when damages are inadequate (or relatively inadequate) as a means of protecting the promisee's expectation interest.³⁸ Professor Douglas Laycock has demonstrated that this rule is now so di-

subparts II(A) and II(B). In the final subpart of the Article, however, I take a different approach, in which I assume the fairness defense means what it says. Under that assumption, the function of a fairness defense is to make use of obscurity to accommodate conflicting values. See *infra* subpart II(C).

36. See *infra* subpart II(C).

37. This term is taken from an article by Professor Meir Dan-Cohen, which is discussed at length *infra* at subpart II(C). See Dan-Cohen, *Decision Rules and Conduct Rules: On Acoustic Separation in Criminal Law*, 97 HARV. L. REV. 625 (1984).

38. See e.g., RESTATEMENT (SECOND) OF CONTRACTS § 359(1) (1981); J. CALAMARI & J. PERILLO, *supra* note 4, § 16-1; 5A A. CORBIN, *supra* note 4, § 1139; D. DOBBS, *supra* note 3, at 57; H. MCCLINTOCK, *supra* note 5, § 60; 11 S. WILLISTON, *supra* note 5, § 1418, at 651-53; E. YORIO, *supra* note 2, § 2.1, at 25, § 2.5, at 40-43.

The choice between specific performance and damages has been the subject of substantial debate. See R. POSNER, *ECONOMIC ANALYSIS OF LAW* § 4.11 (3d ed. 1986); Bishop, *The Choice of Remedy for Breach of Contract*, 14 J. LEGAL STUD. 299, 302-04 (1985); Kronman, *Specific Performance*, 45 U. CHI. L. REV. 351 (1978); Linzer, *On the Amoralism of Contract Remedies—Efficiency, Equity and the Second Restatement*, 81 COLUM. L. REV. 111, 131-39 (1981); MacNeil, *Efficient Breach of Contract: Circles in the Sky*, 68 VA. L. REV. 947, 950-53 (1982); Muris, *The Cost of Freely Granting Specific Performance*, 1982 DUKE L.J. 1053, 1055-58; Schwartz, *Specific Performance*, *supra* note 23, at 271; Ulen, *The Efficiency of Specific Performance: Toward a Unified Theory of Contract Remedies*, 83 MICH. L. REV. 341, 402 (1984); Yorio, *In Defense of Money Damages for Breach of Contract*, 82 COLUM. L. REV. 1365, 1387-88, 1423-24 (1982).

luted that it has little practical meaning.³⁹ Nevertheless, equitable defenses are not likely to arise in the context of a consumer transaction or other sale of fungible goods, because specific performance will not be at issue.⁴⁰ They will appear mainly in connection with sales of land, sales of things likely to have idiosyncratic value, sales of things for which there is no ready substitute, and long-term contractual relations.⁴¹ Most cases discussed in this Article fall into the first three of these categories, and arise from discrete exchanges negotiated on an individual basis. This Article touches only briefly on long-term contracts, which are a separate species of transaction and require a different type of analysis.⁴²

I. VALUES RELATED TO LEGAL AND EQUITABLE STANDARDS OF CONTRACT ENFORCEMENT

When the fairness defense first developed, stricter requirements for equitable relief reflected the political status of equity as an institution. Equity was an independent judicial system. At least in theory, it was subsidiary and supplemental to the law courts, and acted only when justice cried out for a solution that was not avail-

39. See Laycock, *supra* note 29. Laycock's article is a comprehensive survey and analysis of the present status of the irreparable injury rule and its counterpart, the adequacy-of-legal-remedies test, as limits on equitable relief. He concludes that courts do not prefer legal remedies to equitable remedies, as such. See *id.* at 691-93, 701-03. At most they may favor a damage remedy in the case of fungible goods traded in an orderly market when damages and specific performance are interchangeable, and even then their choice of damages reflects a preference for impersonal judgments rather than personal commands. *Id.* at 695-97. In other cases, judicial references to irreparable injury or adequacy of legal remedies disguise different "operative rules," such as a balance of costs and benefits, or a substantive policy that favors a less effective remedy. *Id.* at 765-66.

For another interesting discussion of the adequacy test, see Rendleman, *The Inadequate Remedy at Law Prerequisite for an Injunction*, 33 U. FLA. L. REV. 346, 358 (1981) (adequacy of legal remedies masks judgments about the importance of different legal interests).

40. Although he dismisses the adequacy requirement, Laycock agrees that damages are the prevailing remedy in cases involving fungible goods, primarily because the plaintiff is unlikely to pursue specific performance. See Laycock, *supra* note 29, at 723-24.

41. For surveys of the circumstances in which courts have found the remedy at law inadequate and granted specific performance, see J. CALAMARI & J. PERILLO, *supra* note 4, §§ 16-2 to 16-3; 5A A. CORBIN, *supra* note 4, §§ 1142-1158; D. DOBBS, *supra* note 3, at 58-59; H. MCCLINTOCK, *supra* note 5, § 60, at 150-52, 154-58; 11 S. WILLISTON, *supra* note 5, §§ 1418A, 1419-1419B; Laycock, *supra* note 22, at 703-14. See also RESTATEMENT (SECOND) OF CONTRACTS § 359 (1981).

42. See I. MACNEIL, *THE NEW SOCIAL CONTRACT: AN INQUIRY INTO MODERN CONTRACTUAL RELATIONS* 10-35, 72-77 (1980); Goetz & Scott, *Principles of Relational Contracts*, 67 VA. L. REV. 1089, 1090 (1981).

able within the procedural strictures of law.⁴³ Further, early chancellors often were ecclesiastics.⁴⁴ Thus, it was natural that equity should expect the plaintiff to present a morally appealing case for relief, and should deny relief if the court detected unfairness in the transaction.⁴⁵ Law, on the other hand, was a highly formal system. It was concerned with maintaining order and restraining arbitrary power, and it preferred fixed rules of conduct over vague notions of fairness.⁴⁶

Political considerations between competing tribunals no longer affect decisions to grant equitable relief.⁴⁷ Equity is simply a body of substantive and remedial law historically tied to the chancellors' separate courts. But the different approaches to contract enforcement that developed historically in law and equity correlate with competing values in modern law.

A. *Legal Defenses*

The traditional model of contract enforcement at law holds the promisor liable for the value of the promisee's bargain, subject only to a set of standardized defenses. Legal defenses to contract enforcement include fraud,⁴⁸ variations on fraud,⁴⁹ certain types of

43. G. KEETON, *AN INTRODUCTION TO EQUITY* 22 (6th ed. 1965); F. MAITLAND, *EQUITY* 4-6 (2d ed. 1920); T. PLUCKNETT, *A CONCISE HISTORY OF THE COMMON LAW* 688-89 (5th ed. 1956); 1 J. POMEROY, *supra* note 4, § 50, at 64-65. For an example of how law and equity interacted in the fifteenth century, see *J.R. v. M.P.*, Y.B. 37 Hen. VI 13, pl.3 (1459).

44. G. KEETON, *supra* note 43, at 12; F. MAITLAND, *supra* note 43, at 2-3; T. PLUCKNETT, *supra* note 43, at 685. Ecclesiastics predominated until the sixteenth century. F. MAITLAND, *supra* note 43, at 8-9; T. PLUCKNETT, *supra* note 43, at 688.

45. See F. MAITLAND, *supra* note 43, at 8-9; T. PLUCKNETT, *supra* note 43, at 685-86; 1 J. POMEROY, *supra* note 4, §§ 46, 48-50, 62-65.

46. On the rigidity of the common law, dating from the fourteenth century, see T. PLUCKNETT, *supra* note 43, at 680-81; 1 J. POMEROY, *supra* note 4, §§ 16-17, at 20-24. The influence of hostility to official prerogative is discussed in T. PLUCKNETT, *supra* note 43, at 48-51, 191-95; Rundell, *The Chancellor's Foot: The Nature of Equity*, 27 U. KAN. CITY L. REV. 71, 71-75 (1958).

47. The procedural merger of law and equity courts is discussed briefly in D. DOBBS, *supra* note 3, at 65-68, 81-82.

48. True fraud is knowing misrepresentation, intended to mislead. RESTATEMENT (SECOND) OF CONTRACTS § 162(1) (1981); RESTATEMENT OF CONTRACTS § 471 (1932). See J. CALAMARI & J. PERILLO, *supra* note 4, § 9-13; E. FARNSWORTH, *supra* note 23, § 4.12, at 257; 12 S. WILLISTON, *supra* note 5, § 1487, at 326-27.

49. These include innocent misrepresentation, concealment, and nondisclosure in certain cases. RESTATEMENT (SECOND) OF CONTRACTS §§ 159-161 (1981); RESTATEMENT OF CONTRACTS §§ 471-472 (1932); J. CALAMARI & J. PERILLO, *supra* note 4, §§ 9-14, 9-20; E. FARNSWORTH, *supra* note 23, § 4.11, at 250-57; 12 S. WILLISTON, *supra* note 5, §§ 1497-99, 1500. The second *Restatement* expanded the defense of nondisclosure to cover cases in which the promisee knows the promisor is making a basic mistake, and her

mistake,⁵⁰ incapacity,⁵¹ duress,⁵² impossibility,⁵³ and undue influence.⁵⁴ In contrast to the equitable fairness defense, these defenses

silence violates a standard of "fair dealing." RESTATEMENT (SECOND) OF CONTRACTS § 161(b) (1981). See E. FARNSWORTH, *supra* note 23, § 4.11, at 255-56 (criticizing the mistake-in-basic-assumption defense as overly broad). An indeterminate standard of conduct such as fair dealing is a move away from the traditional model, in the direction of the equitable standard of fairness.

50. The defense of mistake in assumption was once limited to cases of mutual mistake, or cases in which one party was mistaken and the other was aware of the mistake but said nothing. RESTATEMENT OF CONTRACTS §§ 502, 505 (1932). See J. CALAMARI & J. PERILLO, *supra* note 4, § 9-26, at 379; E. FARNSWORTH, *supra* note 23, § 9.3, at 684, § 9.4, at 698; 13 S. WILLISTON, *supra* note 5, § 1543, at 73-78, § 1573, at 486.

The second *Restatement* expanded the defense to cover a broader range of unilateral mistake, if enforcement of the resulting contract would be "unconscionable." See RESTATEMENT (SECOND) OF CONTRACTS § 153(a) (1981). See J. CALAMARI & J. PERILLO, *supra* note 4, § 9-27, at 386-88; E. FARNSWORTH, *supra* note 23, § 9.4, at 696; 13 S. WILLISTON, *supra* note 5, § 1573, at 488-90. Like the second *Restatement's* nondisclosure standard, this is a move in the direction of the equitable fairness defense. See *supra* note 49.

51. The threshold requirement of capacity to contract is a low one. See RESTATEMENT (SECOND) OF CONTRACTS §§ 12-15 (1981); J. CALAMARI & J. PERILLO, *supra* note 4, §§ 8-10; E. FARNSWORTH, *supra* note 23, § 4.2, at 227-28.

52. The traditional definition of duress is coercion or threat that undermines the promisor's will. See RESTATEMENT (SECOND) OF CONTRACTS § 176(1) (1981); RESTATEMENT OF CONTRACTS § 492 (1932); J. CALAMARI & J. PERILLO, *supra* note 4, § 9-2, at 336-37; E. FARNSWORTH, *supra* note 23, § 4.16, at 272-73; Dawson, *supra* note 21, at 256. There is a tendency in modern doctrine to shift the focus of duress from destruction of the promisor's will to unjust enrichment. In other words, the unfairness of the result may bear on the propriety of the pressure used to obtain it. See RESTATEMENT (SECOND) OF CONTRACTS § 176(2) (1981); J. CALAMARI & J. PERILLO, *supra* note 4, § 9-2, at 338; E. FARNSWORTH, *supra* note 23, § 4.17, at 277-78; Dawson, *supra* note 21, at 282-90. Again, incorporation of an indeterminate standard such as unjust enrichment brings the defense closer in character to the fairness defense. See *supra* notes 49-50.

53. The doctrine of impossibility excuses performance when unforeseen difficulties make further performance impracticable. See RESTATEMENT (SECOND) OF CONTRACTS § 261 (1981); J. CALAMARI & J. PERILLO, *supra* note 4, § 13-1; 6 A. CORBIN, *supra* note 4, §§ 1320, 1325; E. FARNSWORTH, *supra* note 23, §§ 9.5-9.6; 18 S. WILLISTON, *supra* note 5, § 1935. The related doctrine of frustration of purpose provides an excuse when the purpose of the contract is undermined by unforeseen events. RESTATEMENT (SECOND) OF CONTRACTS § 265 (1981); J. CALAMARI & J. PERILLO, *supra* note 4, § 13-12; 6 A. CORBIN, *supra* note 4, § 1320, 1353; E. FARNSWORTH, *supra* note 23, § 9.7; 18 S. WILLISTON, *supra* note 5, § 1935, at 23-25. The scope of these excuses has expanded somewhat, but they remain devices for allocating risk in circumstances not covered by the parties' agreement. They are not intended to overrule agreed allocations of risk. See E. FARNSWORTH, *supra* note 23, § 9.6, at 707; Posner & Rosenfield, *supra* note 21, at 98.

54. The defense of undue influence permits rescission of a contract obtained through unfair persuasion. See RESTATEMENT (SECOND) OF CONTRACTS § 177 (1981); J. CALAMARI & J. PERILLO, *supra* note 4, § 9-9; E. FARNSWORTH, *supra* note 23, § 4.20. Unfair persuasion is a broad standard, but the defense normally is limited to confidential relations, marked by dominance and trust. See RESTATEMENT, *supra* § 177 & comment a; J. CALAMARI & J. PERILLO, *supra* note 4, § 9-11; E. FARNSWORTH, *supra* note 23, § 4.20, at 285-86. Further, courts have standardized their application of the undue influence defense by employing an elaborate set of presumptions. J. CALAMARI & J. PERILLO, *supra* note 4, § 9-10.

are relatively narrow and concrete. Further, they focus on the process of agreement, or on filling gaps in the agreement, rather than on the substantive exchange.⁵⁵ They do not excuse the promisor from liability simply because she lacked business acumen and made a bad bargain.

The Uniform Commercial Code and the second *Restatement of Contracts* have altered this picture by adding the defense of unconscionability and expanding the definitions of some other defenses.⁵⁶ But the scope of unconscionability as a legal defense is still in doubt, and commentators have tried hard to contain and delimit it.⁵⁷ In the present discussion, the "legal" model of enforcement refers to the more traditional legal defenses as they stood before unconscionability. In the end, I will return briefly to unconscionability as a generally applicable defense.

The traditional legal model of enforcement fits well with several ideas about the purpose and justification of contract law. One of these is a utilitarian view that conceives a credit economy as an important source of welfare in our society and contract law as a means of fostering that economy. This view derives from the social interest in "security of transactions":⁵⁸ law should encourage promissory exchange by making promises reliable.⁵⁹ The policy in favor of

55. See E. FARNSWORTH, *supra* note 23, § 4.1 (courts have been reluctant to police the substance of private bargains, focusing instead on the status and behavior of the parties). See also Epstein, *supra* note 20, at 293-301 (describing a strictly process-oriented approach). The fraud, incapacity, and mistake-in-assumption defenses address defects in the bargaining process. Frustration and impossibility allocate risks not adequately covered by the contract. To some extent, duress and undue influence involve a review of substantive fairness, but only as it bears on the behavior of the promisee. See J. CALAMARI & J. PERILLO, *supra* note 4, § 9-2, at 338 (duress), § 9-10, at 352 (undue influence); Dawson, *supra* note 21, at 282-90 (duress).

56. See U.C.C. § 2-302 (1977) (unconscionability); RESTATEMENT (SECOND) OF CONTRACTS § 153(a) (mistake), § 161(b) (nondisclosure), § 176(2) (duress), § 208 (unconscionability) (1981). See *supra* notes 15, 49-50.

57. See, e.g., Epstein, *supra* note 20, at 305-14; Leff, *supra* note 4, at 488; Murray, *supra* note 23, at 14; Schwartz, *Nonsubstantive Unconscionability*, *supra* note 23, at 1054. One way to contain unconscionability and make it more rule-like is to confine it to "procedural" unconscionability, which means unfairness in the bargaining process rather than substantive unfairness in the exchange. See Leff, *supra* note 4, at 487-89 (author of the distinction); Epstein, *supra* note 20, at 294-95; Schwartz, *Nonsubstantive Unconscionability*, *supra* note 23, at 1054.

Not all writers have taken such a narrow view; some are willing to carry unconscionability to its full semantic potential. E.g., Ellinghaus, *supra* note 21, at 758; J. WHITE & J. SUMMERS, *supra* note 21, § 4.7.

58. This term comes from R. POUND, AN INTRODUCTION TO THE PHILOSOPHY OF LAW 134 (1954).

59. This is a widely recognized value, shared by writers who might differ in the weight they would accord to a flourishing credit economy, relative to other goals. See,

commercial stability is served by legal rules that ensure the enforcement of bargains within predictable limits.⁶⁰

The importance of reliable enforcement rules to the system of promissory exchange has been challenged. Some writers doubt the impact of legal rules on private activity.⁶¹ Further, Professor Louis Wolcher has argued that a certain degree of protection against regretted decisions is necessary to encourage risk-averse parties to engage in promissory transactions.⁶² If so, the credit system is best served when the law strikes a balance between security and excuse. In general, however, the utility of the market is closely associated with certainty and reliability in law.

The legal model of enforcement also corresponds to economic analysis, which looks at contract law in terms of wealth maximization. Economic analysis is related to the utilitarian ideas described above, but is narrower in its vision of the function of law. It assumes that the object (or one object) of private law is to encourage efficiency in individual affairs so as to maximize social wealth.⁶³ In the area of contract law, economic analysis is based on the two related premises that the only meaningful measure of value is what people are willing to pay and that private exchange between rational actors will increase wealth by moving resources to their highest value.⁶⁴ There is room in this approach for defenses to contract enforce-

e.g., E. FARNSWORTH, *supra* note 23, §§ 1.2-1.3; R. POUND, *supra* note 58, at 133-34; Eisenberg, *supra* note 21, at 744; Fuller & Perdue, *supra* note 28, at 62-63; McClintock, *Mistake and the Contractual Interests*, 28 MINN. L. REV. 460, 463 (1944) (counterposed to individual will); Patterson, *supra* note 29, at 883; Wolcher, *supra* note 28, at 798, 865-67.

60. Professor Fuller's article on contract interests explains the relation between protecting reliance on contracts and full enforcement of the promisee's bargain. See Fuller & Perdue, *supra* note 28. If losses incurred in reliance on a broken contract (including opportunity cost) were readily measurable, compensation for reliance loss would protect the institution of contract. In fact, the effect of reliance is difficult to calculate; therefore an expectancy remedy is necessary to assure commercial actors that they are safe in relying on a promise. *Id.* at 61-62. *But cf.* Wolcher, *supra* note 28, at 865-67 (suggesting that relief from obligation is sometimes necessary to foster promissory activity).

61. See, *e.g.*, Kennedy, *Form and Substance in Private Law Adjudication*, 89 HARV. L. REV. 1685, 1698-1700 (1976) (adding that when some know the rules and some do not, formal rules "intensify the disparity in bargaining power"); Macaulay, *An Empirical View of Contract*, 1985 WIS. L. REV. 465, 467-68. See also M. KELMAN, A GUIDE TO CRITICAL LEGAL STUDIES 43 (1987) (legal uncertainty has no substantial legal effect on contracting parties who may insure against it).

62. See Wolcher, *supra* note 28, at 865-92.

63. See generally R. POSNER, *supra* note 38, §§ 2-2.3, 8.1-8.3.

64. See A. KRONMAN & R. POSNER, *THE ECONOMICS OF CONTRACT LAW* 1-3 (1979); R. POSNER, *supra* note 38, §§ 1.1-1.2, at 5-13; A. POLINSKY, *supra* note 28, at 10. There are several definitions of efficiency. A transaction is Pareto efficient if it benefits at least one person, and leaves no one worse off. A transaction is Kaldor-Hicks efficient if it in-

ment, but only when enforcement produces inefficiencies that negate or outweigh the benefits of exchange.⁶⁵

Economic analysis tends to favor the narrowest versions of existing legal defenses, and its adherents do not like vague equitable defenses based on hardship and unfairness.⁶⁶ A potential defense based on a judge's intuition of unfairness undermines rational calculation of costs and benefits.⁶⁷ Moreover, the fairness defense often rests at least in part on an unequal exchange of value. Judicial inquiry into the adequacy of values exchanged is inconsistent with economic theory because it violates the principle that value is subjective and best left to the judgment of the parties.⁶⁸

Traditional legal defenses also comport with moral theories that value autonomy and view the process of contracting as an exercise of individual freedom. Professor Charles Fried, for example, argues that the institution of contract allows individuals to pursue

creases aggregate wealth, even if someone suffers a loss of value. R. POSNER, *supra* note 38, § 1.2, at 12-13.

Economic analysis assumes that private exchange is efficient because rational actors would not agree to a trade unless each predicted a benefit to herself. See, e.g., A. KRONMAN & R. POSNER, *supra*, at 1-2. But this assumption is accurate only in the Kaldor-Hicks sense, because contracts have external effects. When *A* sells a good to *B*, *B*'s use of the good may cause harm to a third party, *C*, that *A*'s use did not. And if another party, *D*, was competing with *B* for *A*'s good, *D* loses a potential benefit. Thus there is no assurance that the exchange between *A* and *B* is Pareto efficient. Wonnell, *Contract Law and the Austrian School of Economics*, 54 *FORDHAM L. REV.* 507, 511-12 (1986). On the other hand, if everyone is informed and rational and the transaction takes place against a background of efficiency-based tort rules, it should be Kaldor-Hicks efficient.

65. Defenses to contract enforcement have several functions in economic analysis. Lack of information and other distortions in the bargaining process are costly because they undermine the assumption of mutually beneficial exchange. A sanction of nonenforcement can be used to minimize those costs and create incentives for efficient behavior in contract negotiation. For example, a defense based on mistake can be efficient if the promisee was in a better position than the promisor to prevent the mistake. See R. POSNER, *supra* note 38, § 4.4; Kronman, *Mistake*, *supra* note 21, at 2-8. Judge Posner also approves limited defenses based on fraud and duress, in order to deter conduct that otherwise would elicit costly protective responses. See R. POSNER, *supra* note 38, §§ 4.6-4.7. A defense to enforcement also may serve as an efficient default rule to fill gaps in the parties' agreement. For example, when unanticipated difficulties arise in performance, a defense of impossibility can be efficient if the promisee is the party better able to avoid or insure against the risk. R. POSNER, *supra* note 38, § 4.5; Posner & Rosenfield, *supra* note 21, at 88-92.

66. See, e.g., R. POSNER, *supra* note 38, § 4.7, at 104 ("Economic analysis reveals no grounds other than fraud, incapacity, and duress (the last narrowly defined) for allowing a party to repudiate the bargain . . ."); Schwartz, *Specific Performance*, *supra* note 23, at 298-303; Ulen, *supra* note 38, at 396-97 & n.181.

67. Cf. R. POSNER, *supra* note 38, § 20.3 (costs imposed by the choice of standards over rules).

68. See Ulen, *supra* note 38, at 396 n.181.

their ends more fully through mutual trust and cooperation.⁶⁹ Contract obligations between parties are morally charged because they represent the promisor's voluntary invocation of a convention (contract law and custom) that serves autonomy by promoting trust.⁷⁰ From this perspective, breach of an obligation freely undertaken is an intrusion on the rights of the promisee.⁷¹

Professor Randy Barnett's consent theory of contract obligation rests on similar moral foundations.⁷² Barnett sees contract law as one component of a legal order based on individual rights.⁷³ Rights, in his view, mark the boundaries of individual discretion, in order to "facilitat[e] freedom of human action and interaction" in society.⁷⁴ Within this system, contract law governs the transfer of rights, and derives its moral force from the promisor's manifestation of consent to a binding transfer.⁷⁵ Enforcement of contracts on the basis of manifested consent protects the autonomy of both promisor (her expressed will) and promisee (her interest in planning).⁷⁶

Contract theories founded on autonomy admit defenses to contract obligation if the decision to contract was not voluntary. Promises induced by fraud or mistake, for example, are not autonomous expressions and have no moral force.⁷⁷ Of course, the notion

69. See C. FRIED, *supra* note 28, at 1-17.

70. *Id.*

71. *Id.* The ideal of individual autonomy also inspired the "will" theory of contract in earlier literature. See P. ATIYAH, *PROMISES*, *supra* note 28, at 13-22; P. ATIYAH, *FREEDOM OF CONTRACT*, *supra* note 28, at 405-08; C. FRIED, *supra* note 28, at 2; R. POUND, *supra* note 58, at 151-52. Many writers have acknowledged the place of autonomy in contract theory, although not all give it the same weight. See, e.g., Dawson, *supra* note 21, at 287-88; Eisenberg, *supra* note 21, at 746-47; Kronman, *Paternalism*, *supra* note 21, at 780-98; Linzer, *supra* note 38, at 112-13; McClintock, *supra* note 59, at 463; Radin, *Contract Obligation and the Human Will*, 43 COLUM. L. REV. 575 (1943). See also Kennedy, *supra* note 61, at 1718 (identifying the "polar opposites" of individualism and altruism in contract law).

72. See Barnett, *A Consent Theory of Contract*, 86 COLUM. L. REV. 269 (1986).

73. See *id.* at 295.

74. See *id.* at 297. For a general outline of Barnett's system of rights, see *id.* at 291-95.

75. *Id.* at 296-300. Professor Barnett distinguishes his theory from Professor Fried's, primarily on the ground that his standard of consent is an objective one. Consent, to Barnett, means words or conduct that signal consent according to common understanding. See *id.* at 300-07.

76. *Id.* at 306-09.

77. Professor Fried describes the defense of fraud as a necessary corollary of his moral theory of contract obligation, because fraud violates the principles of respect and trust on which the obligation rests. C. FRIED, *supra* note 28, at 77-79. He approaches mistake differently, treating it as a problem outside the scope of his theory. Mistakes are gaps in agreement; therefore they are not governed by the promise theory and must be resolved by reference to other principles. *Id.* at 58-63, 69-73. Some of the principles he

of "voluntary agreement" is susceptible to more than one interpretation. One question is whether an autonomy-based theory of obligation requires inquiry into the subjective will of the promisor.⁷⁸ Another is how cognitive and informational defects affect autonomy and the integrity of private choice. To the extent that choices are distorted in this way, some forms of paternalistic intervention in private exchange may serve to protect rather than inhibit the personal autonomy of the parties.⁷⁹

In general, however, autonomy as a value in contract law is better served by the legal model of enforcement than by the equitable model. Contract as a vehicle for autonomy requires a convention the parties can understand, and a defense based on general unfairness muddles that convention.⁸⁰ Further, at least the more traditional views of contractual autonomy hold that judicial relief against bad judgment or lack of sophistication denies the promisor the respect and equality required by liberal philosophy.⁸¹

suggests—particularly a principle of loss sharing—could lead to a broad standard of relief similar to the fairness defense. A highly indeterminate standard, however, seems inconsistent with Fried's concept of contract law as a convention that enhances autonomy by facilitating mutual trust. *See id.* at 7-17, 84-85. *See also id.* at 93-99, 103-09 (rejecting defenses based on unequal bargaining power or the promisor's need).

Professor Barnett characterizes defenses to contract obligation as circumstances that rebut the *prima facie* case established by a manifestation of consent. Barnett, *supra* note 72, at 318-19. In his words, consent can lose its "normal, presumed significance" as a result of improper inducement, lack of capacity, or gaps in the agreement. *Id.* at 318. But this does not quite tell us what to do with a promisor who, due to her own mistake, meant to signal assent to something other than what she got.

Cf. Kronman, *Contract Law and Distributive Justice*, 89 YALE L.J. 472, 475-98 (1980) (critique of libertarian positions).

78. *See* P. ATIYAH, *PROMISES*, *supra* note 28, at 13-14; C. FRIED, *supra* note 28, at 61-62; Barnett, *supra* note 72, at 300-07. One problem with the will theory of contract obligation is that it indicates a subjective standard of obligation, which impairs the reliability of the contract convention and reduces the opportunity for self-fulfillment that contract law is supposed to provide. *See* 1 A. CORBIN, *supra* note 4, § 106, at 477. For an attempt to harmonize, *see* Barnett, *supra* note 72, at 272-74, 319-20.

79. *See* Kronman, *Paternalism*, *supra* note 21, at 765, 774-98; Sunstein, *supra* note 21. *See also* Kelman, *Choice and Utility*, 1979 WIS. L. REV. 769, 769-72 (1979) (challenging assumptions about consumer choice). Professor Sunstein resists the term "paternalism." *See* Sunstein, *supra* note 21, at 1138. Professor Kronman uses the term but differentiates among forms of paternalism. *See* Kronman, *Paternalism*, *supra* note 21, at 765.

80. *See* C. FRIED, *AN ANATOMY OF VALUES: PROBLEMS OF PERSONAL AND SOCIAL CHOICE* 121-23 (1970) (importance of form to liberty).

81. *See* C. FRIED, *supra* note 28, at 103-04; Epstein, *supra* note 20, at 304-05. Professor Kronman distinguishes between simple disappointment (failed predictions) and "regret," which occurs when the promisor's personal goals have changed in a way that reduces the value of the exchange in her eyes. *See* Kronman, *Paternalism*, *supra* note 28, at 780-81. He suggests that relief against this type of regret is consistent with autonomy, under a view of autonomy that recognizes the moral progress of the individual. *See id.* But he does not advocate relief against simple disappointment. *See id.*

In sum, at least three of the values that influence contract law point toward the legal model of enforcement: the social utility of a market economy, efficient resource allocation, and respect for personal autonomy. In part, the relation is substantive—for varying reasons, each of these values is served by enforcement of bargains, and the legal model enforces more bargains.

Apart from their substantive implications, these three approaches to contract have in common a preference for the formal medium of rules, as opposed to standards. Law in the form of a rule directs the judge to respond in a certain way to certain facts. It applies without regard to context, except as context is built into the rule. It implements a background policy that applies to most of the cases it governs by dictating the outcome of all cases it governs and by preempting further normative evaluation.⁸² Its opposite is a standard, which refers directly to a norm and directs the judge to apply that norm to whatever facts may come before the court.⁸³ Rules have the advantages of certainty of outcome and restraint on judicial discretion, at the expense of accuracy in particular decisions.⁸⁴ Standards allow the judge to observe and tailor the result

82. For discussions of the nature of a "rule," see Ehrlich & Posner, *An Economic Analysis of Legal Rulemaking*, 3 J. LEGAL STUD. 257, 258 (1974); Kennedy, *supra* note 61, at 1687; Powers, *Structural Aspects of the Impact of Law on Moral Duty Within Utilitarianism and Social Contract Theory*, 26 UCLA L. REV. 1263, 1268 (1979); Schauer, *Formalism*, 97 YALE L.J. 509, 510, 539-55 (1988); Schlag, *Rules and Standards*, 33 UCLA L. REV. 379, 384-85 (1985). A rule can be described in terms of its operation: it defines a set of ascertainable circumstances, and dictates a particular result whenever those circumstances are present. See Kennedy, *supra* note 61, at 1687-88; Schlag, *supra*, at 382-83. Or it can be described in terms of its effect on the decisionmaking process: a rule limits the field of inquiry and screens out considerations the decisionmaker might find relevant if she were selecting an outcome in the absence of a rule. See Ehrlich & Posner, *supra*, at 266-67; Powers, *supra*, at 1277-78; Schauer, *supra*, at 520-23. One characteristic implicit in both descriptions is neutrality of terms. To operate as a rule—effectively screening some considerations from the decision—the directive must be free of words that act as normative prisms. See Schauer, *supra*, at 511-20 (distinguishing between formalism in the sense of avoiding or disguising choice and formalism in the sense of following a rule that withdraws choice). See also J. RAZ, *THE AUTHORITY OF LAW* 37-52 (1979) (sources thesis).

Professor Schauer's article on formalism is addressed in part to the question whether rules can constrain decisions. Schauer, *supra*, at 520-32. He argues persuasively that they can: decision according to rule is possible both conceptually (words have a contextual meaning) and psychologically. See *id.*

83. For descriptions of the nature of a standard, see Ehrlich & Posner, *supra* note 82, at 258; Kennedy, *supra* note 61, at 1688; Schlag, *supra* note 82, at 382-83. Most laws are not perfect rules or standards; they fall along an intermediate continuum. Further, the continuum of rules to standards is not the only continuum along which forms of law can be ranged. See Ehrlich & Posner, *supra* note 82, at 259 (rules and discretion); Kennedy, *supra* note 61, at 1689-90 (generality and specificity).

84. Some pros and cons are set out in Kennedy, *supra* note 61, at 1695-1701; Posner & Ehrlich, *supra* note 82, at 261-71; Schauer, *supra* note 82, at 539-42; Schlag, *supra* note

to the needs of the case, at the expense of stability and predictability.⁸⁵ In the area of contract defenses, the equitable fairness defense takes the form of a standard. Legal defenses (with the exception of unconscionability) are closer in form to rules.

The first two views of contract—those concerned with the social function of the market or economic efficiency—favor rules over standards because they are prospective in focus. Both are interested in the effect that legal decisions will have on future conduct, either by reassuring the market that promises are reliable, or by eliciting efficient responses from parties who act in the shadow of law. To achieve these goals, the message of the decision must be clear and stable. The third theory—based on the personal autonomy of contracting parties—is not directly oriented to future conduct, but it requires rules because predictable results are a precondition for autonomous choice.

B. Equity: The Fairness Defense

The values that drive equitable defenses are values of fairness and justice between parties. Dean Robert Stevens found in equity “a more particularized justice” that relieves against individual hardship.⁸⁶ Professor Ralph Newman, another advocate of equitable principles, called equity “the force by which law becomes humanized.”⁸⁷ Equity represents “ideal justice,” “standards of decent and honorable conduct,” “human brotherhood,”⁸⁸ and “the duty to share the burdens of unanticipated misfortune.”⁸⁹ Phrases of this kind may seem out of place in the current contract scholarship. But they express the basic idea of the fairness defense, that one party should not be allowed to profit from a bargain that resulted from the other’s error or lack of sophistication and imposes considerable hardship on the promisor.

Another way to look at equitable defenses is to fit them into Professor Duncan Kennedy’s dialectic conception of contract law. In Kennedy’s cosmography, contract law is subject to polar forces of

82, at 384-89. For a detailed account of the utilitarian benefits and costs of obedience to legal rules, see Powers, *supra* note 82, at 1270-93.

85. See Kennedy, *supra* note 61, at 1695-1701; Schlag, *supra* note 82, at 384-89.

86. Stevens, *A Plea for the Extension of Equitable Principles and Remedies*, 41 CORNELL L. REV. 351, 353 (1956). See also R. POUND, *supra* note 58, at 62-65 (equity as a device for “individualizing the application of law”).

87. Newman, *supra* note 4, at 405.

88. *Id.* at 408.

89. *Id.* at 411. Newman also equated equity with the “principle of individualization of justice.” *Id.* at 413-14.

individualism and altruism.⁹⁰ The fairness defense is an expression of altruism, because it requires individuals to share wealth and sacrifice self-interest for others who are less astute bargainers.⁹¹

Equitable defenses to contract enforcement also are consistent with Aristotle's definition of equity as a correction of gaps and inaccuracies that result from the application of general rules to particular cases.⁹² The fairness defense performs this function well because it takes the form of a standard. It permits the judge to take account of deserving cases that fall through the cracks of legal defenses.

For similar reasons, the ideal of corrective justice may belong in the equity column.⁹³ At least one author, Professor James Gordley, has proposed that the principle of corrective justice supports judicial relief against unequal exchange.⁹⁴ In Gordley's view, any exchange for less than market value is an unjust enrichment, which should be rectified.⁹⁵

90. See Kennedy, *supra* note 61, at 1713-78. Kennedy's vision is interesting, but I am not persuaded that antitheses of individualism and altruism provide an accurate and complete picture of law. I prefer to view individualism and altruism as values that are sometimes but not always in conflict. For example, it is possible to support an individualist legal regime on grounds of social utility, which is in some ways an altruistic value.

91. *Id.* at 1717-18. The fairness defense also fits Kennedy's description of the relation between substance and form. Throughout his article, Kennedy traces connections between individualism and the use of rules, and between altruism and the use of standards. *But cf.* Schlag, *supra* note 82, at 420 (arguing that there is no consistent relation between altruist values and the use of standards).

92. Aristotle described equity as "a correction of law where it is defective owing to its universality." ARISTOTLE, *NICOMACHEAN ETHICS* bk. V, ch. 10, *1137b.

93. The term corrective justice refers to Aristotle's discussion of justice in book V of the *Nicomachean Ethics*. ARISTOTLE, *supra* note 92, book V, ch. 4 at *1132. For a sample of different conceptions of corrective justice, see Coleman, *Corrective Justice and Wrongful Gain*, 11 J. LEGAL STUD. 421, 423-28 (1982) (rectification based on fault or taking); Epstein, *A Theory of Strict Liability*, 2 J. LEGAL STUD. 151, 160-89 (1973) (liability based on causation); Fletcher, *Fairness and Utility in Tort Theory*, 85 HARV. L. REV. 537, 540-42 (1972) (reciprocity); Nickel, *Justice in Compensation*, 18 WM. & MARY L. REV. 379, 387-88 (1976) (protection of just holdings); Posner, *The Concept of Corrective Justice in Recent Theories of Tort Law*, 10 J. LEGAL STUD. 187, 201-06 (1981) (wealth maximization); Schroeder, *Corrective Justice and Liability for Increasing Risks*, 37 UCLA L. REV. 439, 451-69 (1990) (liability based on personal responsibility, *ex ante*; compensation based on harm caused, *ex post*); Simons, *Corrective Justice and Liability for Risk-Creation: A Comment*, 38 UCLA L. REV. 113 (1990) (a reply to Schroeder).

94. See Gordley, *supra* note 20.

95. See *id.* at 1588-1625. The fairness defense usually rests on a combination of circumstances, including defects in the bargaining process as well as inequality in the values exchanged. See *supra* notes 16-20, and accompanying text. Gordley's argument goes further, because it treats an unequal result as unjust in itself without regard to the contract process. See Gordley, *supra* note 20, at 1636-37. At the same time, he softens the impact of substantive review by tying it to a standard of market price. See *id.* at 1609-17.

At the substantive level, the connection between corrective justice and equitable defenses is imperfect because it depends on the contestable assumption that it is wrong to enforce a hard bargain. Corrective justice (in my view) is purely a remedial principle that requires correction of wrongful gain and loss.⁹⁶ It does not say when gains are wrongful and when they are not; therefore it cannot justify a substantive standard of contract enforcement without the assistance of some other norm.⁹⁷

At the formal level, however, there is a stronger connection. To the extent that corrective justice implies the most perfect remedial justice possible between parties, it is better served by a standard of fairness than by more determinate legal defenses. Legal defenses are designed for clarity and accessibility at the time the contract is formed. The fairness defense is a more effective tool for corrective justice because it allows the judge to respond directly to the situation before the court, after a breach has occurred. Its object is not to regulate future conduct in a range of similar cases, but to undo an unjust result between parties.⁹⁸

Finally, the fairness defense can be identified, for better or worse, with paternalism. Stated favorably, a fairness defense allows the judge to identify cognitive defects or gaps in information that distorted the promisor's decision to enter into the contract, and to give relief against subsequent regret.⁹⁹ Stated less sympathetically,

96. See ARISTOTLE, *supra* note 92, bk. V, ch. 4, at *1132.

97. A number of tort theorists have tried to show that corrective justice is on their side. See *supra* note 93. If anything, their varying interpretations show that corrective justice cannot carry a substantive burden. See Alexander, *Causation and Corrective Justice: Does Tort Law Make Sense?*, 6 LAW & PHIL. 1, 7-11 (1987) (entitlement theories cannot be tied to corrective justice without independent normative justification); Posner, *supra* note 93, at 190, 201-03 (separating the "procedural" principle of corrective justice from the substantive definition of wrongdoing).

98. Aristotle's description of corrective justice suggests an individualized process of adjustment between parties. See ARISTOTLE, *supra* note 92, bk. V, ch. 4, at *1132a. See also Alexander, *supra* note 97, at 12, 16 (corrective justice as a "backward-looking" process, equated with current tort law); Wright, *Causation, Responsibility, Risk, Probability, Naked Statistics, and Proof: Pruning the Bramble Bush by Clarifying the Concepts*, 73 IOWA L. REV. 1001, 1064 (1988) (justice "based on individual autonomy and individual responsibility").

This interpretation is not universal. Judge Posner, for example, believes that corrective justice can be achieved in the aggregate by imposing costs on a pool of potential wrongdoers. Posner, *supra* note 93, at 198-99, 202-03. But see Coleman, *supra* note 93, at 425 n.10 (deterrence is not rectification). Cf. Schroeder, *supra* note 93, at 448-49 (on the liability side, responsibility should be determined *ex ante*). If Posner is correct, corrective justice has very little content. To me, if corrective justice means anything, it means that one aspect of justice is rectification on an individual basis.

99. See Kronman, *Paternalism*, *supra* note 21; Sunstein, *supra* note 21, at 1171.

a fairness defense allows the judge to question the competence of the promisor's expressed choice on an individual basis. Further, this individualized form of intervention may pose a greater threat to autonomy than paternalistic regulation of standardized transactions based on general conclusions about a group of promisors.¹⁰⁰

Distilling this, the equitable model of enforcement, which grants relief from contract obligations on the basis of unfairness in the process and substantive content of a bargain, exercises compassion at the expense of utility and stability. It imposes ethics of community and sharing, in opposition to individualism. It is designed to accomplish individual justice retrospectively rather than to channel prospective conduct. And it operates by means of standards rather than rules.

II. WHY IS THERE A DOUBLE STANDARD?

The effect of disparate legal and equitable contract defenses is that two contract remedies, damages and specific performance, are held to different standards. But the fact that different values are served by each set of defenses does not explain why courts differentiate between two remedies that are both supposed to protect the promisee's expectations. The remainder of this Article outlines three possible answers. In the first two subparts, I will set aside the conflict in substantive values and consider whether the different defenses can be explained in remedial terms, according to differences in the operation of the two remedies. In the third subpart, I will return to the substantive and formal implications of legal and equitable defenses and discuss the role of equitable defenses as a means of reconciling opposing values in contract law.

A. *Specific and Substitutional Relief*

Both damages and specific performance are designed to give the promisee the benefit of the bargain.¹⁰¹ But there are differences

100. Kronman's analysis of paternalism is concerned mainly with rules that invalidate certain types of agreement based on the cognitive or informational disadvantages of the classes of actors most likely to enter into them. Kronman, *Paternalism*, *supra* note 21. Paternalistic judgments on an individual basis are more directly intrusive, because they are personalized. On the other hand, the decision to grant an equitable defense in a particular case on paternalistic grounds applies only to the promisor who regrets her choice, and does not disable all like actors from transacting business. See Dawson, *supra* note 21, at 264; Epstein, *supra* note 20, at 304-05.

101. Specific performance delivers the bargain in kind, by injunction. At least in theory, the standard measure of damages delivers the value of the bargain in money. For material on the expectancy measure of damages, see *supra* note 28.

between the two remedies that may justify a special defense to specific relief in some cases. One difference is the form of the remedy: specific performance gives the promisee her bargain in kind, while damages provide a money substitute.

This subpart of the Article is concerned with the different effects of specific and substitutional relief. In practice, a damage remedy may also differ from specific performance because it does not give the promisee the full value of the bargain, but that problem is postponed to the next subpart.¹⁰² In order to isolate the consequences of specific relief, this subpart assumes that the damage remedy is equivalent to the value of performance.¹⁰³

There are reasons for special defenses to specific relief, but they are quite narrow. They do not explain a generally higher standard of fairness for specific performance.

1. *External Effects of Specific Relief.*—The simplest case for a distinction between enforcement of a contract by specific performance and enforcement by damages is when physical performance has negative effects on third parties or the public.¹⁰⁴ For example, suppose a buyer and seller enter into a land-sale contract; then the seller conveys the land to a third party who moves in and makes improvements. Specific performance imposes substantial hardship on the third party, but a damage remedy does not affect her.¹⁰⁵ Or suppose a school system purchases land and builds a school knowing that a gas station holds an option to purchase a corner of the parcel. There are no equities on the side of the school system, but specific

102. See *infra* subpart II(B).

103. This assumption can never be completely accurate because costs of litigation are not compensated in our system. See Farber, *Reassessing the Economic Efficiency of Compensatory Damages for Breach of Contract*, 66 VA. L. REV. 1443, 1450-51 (1980). Litigation costs, however, are not a significant point in the comparison between specific performance and damages because they affect both remedies. For a discussion of other ways in which the assumption of full compensation breaks down and the value of the two remedies begins to diverge, see *infra* text accompanying notes 161-172.

104. See RESTATEMENT (SECOND) OF CONTRACTS § 364(b) (1981); J. CALAMARI & J. PERILLO, *supra* note 4, § 16-13, at 676; 5A A. CORBIN, *supra* note 4, § 1169; H. MCCLINTOCK, *supra* note 5, § 70, at 193-94; E. YORIO, *supra* note 2, § 5.6, at 114.

105. This example assumes the third party had only constructive notice of the prior contract, and made improvements in good faith. One case along these lines is *Kelly v. Central Pac. R.R. Co.*, 74 Cal. 557, 16 P. 386 (1888). A railroad had offered land for sale at low prices to occupants, in order to encourage settlement along a railway. Kelly misrepresented that he was an occupant and purchased land. Meanwhile, the real occupant made improvements on the land. The court denied Kelly's claim to specific performance, in part because of the hardship it would have imposed on the third-party occupant. See *id.* at 561, 16 P. at 388.

performance would result in danger and inconvenience to schoolchildren.¹⁰⁶

The fairness defense is broad enough to take these considerations into account; in the school case, for example, the court denied specific performance and limited the gas station's remedy to damages.¹⁰⁷ And the result is sound, at least when expectancy damages provide equivalent value to the promisee.¹⁰⁸ This explanation, however, covers only a small category of cases in which significant third-party interests are at stake, and it does not go far in explaining the fairness defense.

2. *Efficiency*.—As a general matter, equitable defenses are at odds with efficiency goals because they undermine rational calculation. Occasionally, however, a fairness defense can be used to avoid inefficient consequences of a specific remedy. One tenet of economic analysis in contract law is that breach is sometimes more efficient than performance, and efficient breach should be encouraged. Specifically, breach is efficient if the promisor can realize a net gain in the form of higher profits or saved costs by refusing to perform and applying the resources performance would command to another use.¹⁰⁹ As long as the damage measure compensates the promisee for the lost value of her bargain, the choice to breach is efficient because it allows the resources to be applied to a higher-valued use.¹¹⁰

The concept of efficient breach does not mean that a damage

106. *Whitlow v. Board of Educ.*, 108 Kan. 604, 196 P. 772 (1921).

107. *See id.*

108. The parties may negotiate a different result. The effect of the equitable defense is to allocate an entitlement to the third party for purposes of bargaining over the resource.

109. *See* A. POLINSKY, *supra* note 28, at 31-34; R. POSNER, *supra* note 38, § 4.8, at 106-07, 118; Bishop, *supra* note 38, at 299-300; Goetz & Scott, *Efficient Breach*, *supra* note 28, at 558-59; Ulen, *supra* note 38, at 344-45. Efficient breach theory is criticized in D. LAYCOCK, *supra* note 3, at 369-80; Linzer, *supra* note 38, at 117-34, 138-39; MacNeil, *supra* note 38, at 950-57; Wolcher, *supra* note 28, at 838-43, 864.

The notion of efficient breach is consistent with Justice Holmes's view of contract obligation as an option to perform or pay damages for breach. *See* Holmes, *Path of the Law*, 10 HARV. L. REV. 456, 462 (1897); RESTATEMENT (SECOND) OF CONTRACTS ch. 16, at 100 (1981) (introductory note). *See* R. POSNER, *supra* note 38, at 106.

110. Economists often defend the expectancy measure in terms of efficient breach. Faced with liability for the value of the promisee's bargain, a rational promisor will breach if, but only if, an alternative use of resources has a higher value. *See* A. POLINSKY, *supra* note 28, at 32-34; R. POSNER, *supra* note 38, § 4.8, at 108; Cooter & Eisenberg, *supra* note 28, at 1463; Farber, *supra* note 28, at 321 (neoclassical model). *Cf.* Farber, *supra* note 103 (due to costs of detection and enforcement, expectancy damages do not result in optimal performance and breach).

remedy is more efficient than a specific performance remedy. Damages permit the promisor to breach, while specific performance compels performance on pain of contempt. But the parties can bargain out of any remedy decreed by the court. Thus a judge's choice between specific performance and damages does not necessarily determine whether performance will occur. Its real impact is its effect on the transaction costs of collateral negotiation.¹¹¹

From this conclusion a number of elaborate transaction-cost analyses have followed. There may be *ex ante* costs in negotiating alternative sanctions for breach,¹¹² *ex post* costs in negotiating a compromise,¹¹³ *ex post* cover costs,¹¹⁴ and probably other costs as well.¹¹⁵ All such costs in the wake of a remedial decision are without economic benefit because they are spent on distributing wealth between parties, with no new gain in efficiency.¹¹⁶

The debate over transaction costs has not yielded a general conclusion in favor of damages or specific performance. Nevertheless, in some situations it is clear that bargaining out of specific performance will be very costly. An example is *Van Wagner Advertising Corp. v. S & M Enterprises*.¹¹⁷ The contract at issue in *Van Wagner* was a lease of billboard space on a building wall facing an exit from the Queens-Midtown Tunnel in New York City.¹¹⁸ The lease had about nine years to run at the time of the suit. Shortly after entering into the lease, the lessor sold the building to S & M, a real estate developer with plans that undoubtedly called for the demise of the billboard.¹¹⁹ When S & M attempted to cancel the lease, the lessee,

111. See R. POSNER, *supra* note 38, § 4.11, at 118; Bishop, *supra* note 38, at 300; MacNeil, *supra* note 38, at 950-57; Ulen, *supra* note 38, at 369-70.

112. See Kronman, *supra* note 38, at 365-69; Schwartz, *Specific Performance*, *supra* note 23, at 278-84; Yorio, *supra* note 38, at 1377-80.

113. See R. POSNER, *supra* note 38, § 4.11, at 118; Bishop, *supra* note 39, at 311-14; Kronman, *supra* note 38, at 365-69; Schwartz, *Specific Performance*, *supra* note 23, at 284-86; Ulen, *supra* note 38, at 379-83; Yorio, *supra* note 38, at 1380-81.

114. See R. POSNER, *supra* note 38, § 20.3, at 513-14; Bishop, *supra* note 38, at 314-16; Schwartz, *supra* note 38, at 286-91; Ulen, *supra* note 38, at 385-89; Yorio, *supra* note 38, at 1381-85.

115. See MacNeil, *supra* note 38, at 957-60 (transaction costs are too complex and variable to permit useful efficiency analysis).

116. From an economic perspective, costs spent in redistributing wealth are "dead weight" social costs. They produce no new movement in resources; therefore they undercut the overall efficiency of the breach. Schwartz, *Specific Performance*, *supra* note 23, at 285. See R. POSNER, *supra* note 38, § 3.7, at 55.

117. 67 N.Y.2d 186, 492 N.E.2d 756, 501 N.Y.S.2d 628 (1986).

118. *Id.* at 189, 492 N.E.2d at 757, 501 N.Y.S.2d at 629.

119. *Id.* at 190, 492 N.E.2d at 758, 501 N.Y.S.2d at 630.

Van Wagner, brought an action for specific performance.¹²⁰

In effect, a specific performance remedy would have given the billboard lessee a stake in the real estate project that was not part of its original bargain.¹²¹ It does not require sophisticated economic analysis to conclude that high transaction costs would have ensued.¹²² And in fact, an efficiency-minded court denied specific performance on the ground of "undue hardship."¹²³ It is hard to invoke sentiments of altruism and humanity in favor of this defendant, a New York real estate developer. But a hardship defense makes sense in terms of efficiency.

Efficiency, however, is at best a limited explanation for a special defense to specific performance. *Van Wagner* is an exceptional case, in which the potentially large transaction costs were obvious. Much more often, analysis of transaction costs on a case-by-case basis will be costly and uncertain. And there is no gain in efficiency unless the benefit of allowing the defense exceeds the cost of litigating its applicability.

3. *Distributive Effects.*—Economists are not concerned with the ultimate distribution of gains resulting from an efficient breach between parties; they care only about the transaction costs of negotiation.¹²⁴ But the parties are interested, and the choice between specific and substitutional relief can affect their respective wealth.

120. *Id.*

121. There is no indication that the lessee bargained for a share of future development opportunities, nor that it attained its leverage through an investment in productive information. *Cf.* Kronman, *Mistake*, *supra* note 21, at 9-18 (discussing the social value of protecting the right to profit from deliberately acquired information). In fact, the lessor had reserved a right to terminate the lease in anticipation of a sale. *Van Wagner*, 67 N.Y.2d at 189-90, 492 N.E.2d at 758, 501 N.Y.S.2d at 630.

122. These parties are likely to be hostile and intransigent. *See* D. LAYCOCK, *supra* note 3, at 340-41, 912-13 (bilateral monopoly); A. POLINSKY, *supra* note 28, at 18-19 (strategic behavior); R. POSNER, *supra* note 38, §§ 4.8, 4.11, at 106, 118-19 (bilateral monopoly); Leff, *Injury, Ignorance and Spite—The Dynamics of Coercive Collection*, 80 YALE L.J. 1, 18-19 (1970) (spite).

123. *Van Wagner*, 67 N.Y.2d at 195, 492 N.E.2d at 761, 501 N.Y.S.2d at 633. The court did not rely expressly on efficiency in this part of its opinion, but it obviously was familiar with current economic literature. *See id.* at 192-93, 492 N.E.2d at 759-60, 501 N.Y.S.2d at 632 (discussing substitutability of performance).

To temper the risk of undercompensation, the court combined its denial of specific performance with a liberal treatment of damage rules. *Id.* at 195-96, 492 N.E.2d at 761-62, 501 N.Y.S.2d at 633-34. For example, the lessee's damage claim might have failed the test of certainty of proof due to contingencies in the lease. *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS § 352 (1981). But the court relaxed the normal requirement of certainty and resolved doubts in favor of the lessee. *See* 67 N.Y.2d at 195-96, 492 N.E.2d at 761-62, 501 N.Y.S.2d at 633-34.

124. *See* A. POLINSKY, *supra* note 28, at 7-10, 119-27; R. POSNER, *supra* note 38, § 3.7, at

Both remedies protect the promisee's expectations,¹²⁵ but they allocate the benefits of breach to opposite parties. One function of an equitable defense is to alter that allocation.

This explanation of the fairness defense rests on two factual premises, which are not present in all cases. The first is that a damage remedy will compensate the promisee for the value she placed on performance. There are a variety of defects in the damage remedy that belie this assumption, but it holds true in some cases, such as sales of relatively fungible land.¹²⁶

The second premise is that breach of the contract is efficient in that it is possible for the promisor to compensate the promisee for the lost value of performance and still profit. There are several reasons why a breach may turn out to be efficient. The promisor may have new opportunities that offer higher profits than the original contract.¹²⁷ Or the promisor may have encountered difficulties that increase the cost of performance beyond what she anticipated and beyond the consideration provided for in the contract.¹²⁸ The new costs may be monetary costs, or subjective costs that arise because the promisor's valuation has changed and she regrets her initial choice.¹²⁹

55; Goetz & Scott, *Efficient Breach*, *supra* note 28, at 568; Schwartz, *Specific Performance*, *supra* note 23, at 285; Ulen, *supra* note 38, at 370.

125. See *supra* notes 28, 103 and accompanying text.

126. Reasons why damages may not fully compensate the promisee are discussed *infra* at text accompanying notes 161-172. The assumption that damages and performance have equal value for the promisee also conflicts with the maxim that specific performance is not available when damages are adequate. See *supra* notes 38-41 and accompanying text. When land is involved, however, courts have granted specific performance without serious inquiry into the adequacy of damages. See, e.g., *Kitchen v. Herring*, 42 N.C. 190 (1851); *D. Dobbs*, *supra* note 3, § 12.10, at 847-48. See also Laycock, *supra* note 29, at 691-93, 701-03 (suggesting that there is no real adequacy limit).

127. For illustrations, see R. POSNER, *supra* note 38, § 4.8, at 107; Linzer, *supra* note 38, at 114-16. The *Van Wagner* case is a real life example; the property at issue would be much more valuable as part of a new development than in its current incarnation as a billboard. See *Van Wagner*, 67 N.Y.2d 186, 492 N.E.2d 756, 501 N.Y.S.2d 628 (1986) (discussed *supra* at text accompanying notes 117-123). But see D. LAYCOCK, *supra* note 3, at 369-70 (suggesting that what appears to be efficiency may really be an error in assessment of value to the promisee).

128. For illustrations, see R. POSNER, *supra* note 38, § 4.8, at 106-07; Ulen, *supra* note 38, at 353. Impracticability of performance and frustration of purpose are defenses to both damages and specific performance, but the fairness defense has a longer reach. See *Castaldi v. Multer*, 117 A.D.2d 699, 498 N.Y.S.2d 438 (1986); *Patel v. Ali*, [1984] 1 Ch. 283; RESTATEMENT (SECOND) OF CONTRACTS § 364 comment a (1981); E. YORIO, *supra* note 2, § 5.4.2, at 109-10. Materials on impracticability and frustration are collected *supra* at note 53.

129. Courts are not quick to give relief on the basis of troubles that arise after the contract is made, but they may do so if the promisor's difficulties are extreme in propor-

Whatever the source of potential gains from breach, a specific performance remedy allocates them to the promisee, while a damage remedy allocates them to the promisor. If the court grants specific performance, the promisee controls the resources, and can force the promisor to pay to regain them.¹³⁰ The promisor will pay any amount up to the full value they hold for her in terms of opportunity or saved cost. On the other hand, if the court limits the promisee's remedy to damages the promisor is free to keep whatever she can gain from the breach (after paying for the promisee's lost performance value). Professor Christopher Wonnell has called the promisee's interest in a share of gains from breach her "extortion interest."¹³¹ Specific performance vindicates the extortion interest; damages do not.

An equitable fairness defense allows the judge to manipulate the distribution of gains from breach.¹³² For example, in *Patel v. Ali*,¹³³ Mrs. Ali had agreed to sell her home to the Patels. Due to complications beyond either party's control, the closing was delayed for more than four years.¹³⁴ Meanwhile, Mrs. Ali developed cancer and lost a leg. She also had two new babies. And her husband went to jail.¹³⁵ Then the Patels sued for specific performance of their contract.

By the time of the suit, Mrs. Ali was heavily dependent on nearby relatives and friendly neighbors. As a result, her idiosyncratic valuation of the house had increased and she regretted her contractual choice.¹³⁶ In plainer terms, she did not want to give up her home. The court's response was to deny specific performance

tion to the benefit of specific performance to the promisee. For an example of unforeseen monetary costs, see *RESTATEMENT (SECOND) OF CONTRACTS* § 364 comment a, illustration 4 (1981) (farmer B's cows are overtaken by a disease). For examples of a change in the promisor's subjective valuation, see *Castaldi*, 117 A.D.2d 699, 498 N.Y.S.2d 438 (defendants and their eight children could not find another house); *Patel*, [1984] 1 Ch. 283 (discussed *infra* at text accompanying notes 133-139).

130. See R. POSNER, *supra* note 38, § 4.11, at 118. In effect, the promisor is the owner of the promisee's resources. See MacNeil, *supra* note 38, at 962-63.

131. Wonnell, *The Abstract Character of Contract Law*, 22 CONN. L. REV. 437, 480 (1990); see also E. YORIO, *supra* note 2, § 4.3.3, at 84-86, § 15.5, at 396. Not all observers would call this extortion. See D. LAYCOCK, *supra* note 3, at 370-71.

132. Professor Yorio makes the point that an equitable defense can prevent the promisee from demanding an overcompensatory settlement. E. YORIO, *supra* note 2, § 4.3.3, at 84-86.

133. [1984] 1 Ch. 283.

134. The main obstacle to closing was that a co-owner of the property had disappeared and could not be served with process. *Id.* at 285-86.

135. *Id.* at 286.

136. See Goetz & Scott, *Efficient Breach*, *supra* note 28, at 568-77 (idiosyncratic value);

on the ground of hardship, but leave open the possibility of a damages claim.¹³⁷

Looking at the facts of *Patel v. Ali*, it is easy to see how the choice between specific and substitutional relief affects the distribution of value between parties. Breach had a large subjective value for Mrs. Ali. Specific performance placed this value in the control of the Patels,¹³⁸ but a fairness defense returned it to Mrs. Ali. The Patels would realize the value they placed on the house, but no more.¹³⁹

This interpretation of the fairness defense raises difficult questions about when a particular distribution of benefits from breach is unfair. In many cases it may be perfectly just to allocate the gain to the promisee by means of specific performance. The promisor agreed to perform and took the risk of a change in her valuation of the resources she committed to performance. In fact, Professor

Kronman, *Paternalism*, *supra* note 21, at 780-82 (regret of contractual choice); Wolcher, *supra* note 28, at 799-803 (same).

Apart from distribution of gains from breach, specific relief also may make the experience of regret more vivid. Professor Kronman has suggested that the psychological effect of regret is greatest when the promisee must perform in kind. A damage remedy allows a promisee to distance herself from the consequences of her choice and "depersonalize" her regret. Kronman, *Paternalism*, *supra* note 28, at 783.

137. See [1984] 1 Ch. at 288. Another example is *Castaldi v. Multer*, 117 A.D.2d 699, 498 N.Y.S.2d 438 (1986) (specific performance of a purchase and sale contract would cause hardship on defendant's eight children).

138. The Patels, as rational economic actors, would settle with Mrs. Ali for some amount between the value of the house to them and its value to Mrs. Ali. But if, as is likely, she had little to pay, the Patels might insist on performance and the value of the breach would be lost.

139. The court made clear that the Patels were entitled to a damage remedy. See [1984] 1 Ch. at 288-89. Normally, damages for a deliberate breach include compensation for the lost value of the bargain. See *infra* note 153.

The same account of the fairness defense—as a means of controlling the distribution of gains from breach—could apply to a case in which the gain results from an opportunity for higher profit rather than an increase in costs. In *Van Wagner*, for example, the billboard lessor could make more money from a new development than it could from a billboard lease. Specific performance would have allowed the lessee to control this value, while an equitable defense allocated it to the lessor. See *Van Wagner Advertising Corp. v. S & M Enters.*, 67 N.Y.2d 186, 194-95, 492 N.E.2d 756, 760-61, 501 N.Y.S.2d 628, 633 (1986) (discussed *supra* at text accompanying notes 117-123). See E. YORIO, *supra* note 2, § 15.5, at 396.

In terms of fair distribution, a case of this type is not as compelling as *Patel v. Ali*. One difference is that the promisor will realize affirmative value from the alternative use of resources, which it can apply to a settlement with the promisee. In contrast, the result of Mrs. Ali's breach was a saving of subjective value, which she could not use to pay off the Patels. Nevertheless, in a case such as *Van Wagner*, in which the new opportunity is well outside the range of values explicitly or implicitly allocated in the contract, it is hard to see why the promisee should enjoy a windfall share.

Dawson suggested that a damages remedy that allows the promisor to gain from a breach is an unjust enrichment at the expense of the promisee.¹⁴⁰ But sometimes the events that cause a change in valuation are outside any plausible view of risk allocation and voluntary choice.¹⁴¹ It is hard to maintain that the Patels deserved to share in the benefit Mrs. Ali obtained by her breach, or that specific performance is necessary to vindicate Mrs. Ali's personal autonomy.¹⁴²

The important point is that whatever its substantive content, an equitable defense based on fair distribution of gains from breach addresses a real difference between specific and substitutional relief. If there are cases in which it is unfair to allow the promisee to control the proceeds of an efficient breach, a defense that applies only to specific performance and not to damages is understandable. On the other hand, allocation of gains from breach is only a partial explanation of equitable defenses. It applies to a certain type of case, in which there are net benefits from breach (after compensating the promisee's expectation interest) and the reason for the defense is to prevent an unfair distribution of those benefits.¹⁴³ Applications of the fairness defense that do not fit this profile need another rationale.

140. See Dawson, *Restitution or Damages?*, 20 OHIO ST. L.J. 175, 186-89 (1959) (favoring a profit measure of damages for breach).

141. In *Patel v. Ali*, for example, there was not only an extraordinary series of misfortunes, but also an unusual delay in closing the sale. The extended time span of the contract helped to distinguish Mrs. Ali's difficulties from the normal risk of changed conditions. See [1984] 1 Ch. at 288.

A fairness defense based on distribution of gains from breach should be confined to cases in which there is a large increase in the promisor's cost of performance due to conditions that are outside the range of risks associated with the contract. It might also be limited to transactions that affect important distributive interests of the parties, such as the sale of a home. Cf. Kronman, *Paternalism*, *supra* note 21, at 771-72. And the court should satisfy itself that a damage remedy will at least compensate the promisee for reliance loss. See [1984] 1 Ch. at 289 (escrow order pending determination of damages).

142. Cf. C. FRIED, *supra* note 28, at 20 ("holding people to their obligations is a way of taking them seriously"). Fried states that proper respect for the promisor's autonomy entails an expectancy remedy, though he does not discuss specific performance. *Id.* at 20-21. But see Craswell, *Contract Law, Default Rules, and the Philosophy of Promising*, 88 MICH. L. REV. 489, 517-20 (1989) (an autonomy-based theory of contract obligation does not dictate a choice of remedy); Wolcher, *supra* note 28, at 826-30 (same).

143. A court might be moved to deny specific performance on distributive grounds even when a damage remedy will not fully compensate the promisee's expectations. But in that case an equitable defense is more problematic: it does more than just redistribute gains available from breach, and it operates at the expense of the purposes served by an expectancy measure of damages. Thus it overlaps with the issues discussed *infra* at subpart II(B).

4. *Relational Considerations.*—There is one other type of case in which an equitable fairness defense might be explained in terms of the different remedial effects of specific and substitutional relief. The setting for this category is a long-term business relationship governed by a contract the court finds to be unconscionably one-sided in its allocation of risk. At the point of breach and enforcement, the objectionable risk may or may not have materialized. If it has, there is no difference between specific and monetary relief; both enforce the contractual allocation of risk. But if the risk that makes the contract unfair has not yet come to pass, specific performance perpetuates the risk, while a damage remedy does not.

For example, assume a farmer has contracted to sell several years' output of carrots to a corporate buyer at a fixed price.¹⁴⁴ The contract is a printed form prepared by the buyer, which gives the buyer wide powers to refuse delivery of carrots but forbids the farmer to sell elsewhere without the buyer's consent. Rightly or not, the court finds these terms unconscionable. The buyer, however, has not attempted to refuse carrots. Instead, the farmer breached in order to accept a higher offer from someone else.

At least if the unconscionable terms are inseparable from the rest of the contract, specific performance requires the farmer to continue the relation on those terms—the buyer still has the right to reject carrots.¹⁴⁵ A damage remedy releases the farmer from the harsh refusal terms, though it holds her to the agreed price. In the right case, this difference may be a reason to recognize a fairness defense, applicable only to specific performance.¹⁴⁶

144. This example is based loosely on the facts of *Campbell Soup Co. v. Wentz*, 172 F.2d 80 (3d Cir. 1948). The contract in *Campbell Soup* was for one season's output only. The court denied specific performance on the ground of unconscionability, leaving Campbell's with a liquidated damages remedy. *Id.* at 83. The case is discussed in D. LAYCOCK, *supra* note 3, at 367-72.

145. If the terms of the contract are separable, the court can grant specific performance, but condition the remedy in a way that removes the offending terms. *See Leasco Corp. v. Taussig*, 473 F.2d 777, 785-86 (2d Cir. 1972) (ordering specific performance of sale of corporation on the condition that the parties agree on a more equitable price); *Jensen v. Southwestern States Management Co.*, 6 Kan. App. 2d 437, 443, 629 P.2d 752, 757 (1981) (refusing to order specific performance of a 50-year-old mineral deed that gave the owner an option to purchase the use of the surface, unless the owner agreed to pay current market value); E. YORIO, *supra* note 2, § 1.3, at 14-15. Conditional relief is a traditional feature of equity under the maxim that one who seeks equity must do equity. *See H. MCCLINTOCK*, *supra* note 5, § 25, at 55-56; 2 J. POMEROY, *supra* note 4, §§ 388, 392. A similar remedial discretion is incorporated in the unconscionability provisions of the Uniform Commercial Code. *See U.C.C.* § 2-302(1) (1977).

146. Professor Dobbs defends the *Campbell Soup* case on a different basis. He argues that by recognizing an equitable defense and limiting the promisee to damages, the

There are several problems with this use of a fairness defense. First, it only postpones to another case the difficult question of unconscionability as a complete defense to enforcement. If the risks imposed on the promisor by a one-sided contract do materialize (for example, if the buyer refuses a shipment of carrots), the court will have to decide what degree of procedural or substantive imbalance justifies tampering with the agreed terms of exchange.¹⁴⁷

Second, the assumption that a damage remedy will protect the promisee's expectations is especially tenuous in the context of a long-term contract. Specific performance is available for enforcement of long-term contracts because damages are too uncertain; the court cannot predict the value of future performance with reasonable accuracy at the time of trial.¹⁴⁸ Problems of this kind are always in the background when the court considers an equitable defense, because specific performance becomes important only when damages are not satisfactory to the promisee. But the defects of the damage remedy are more serious in long-term contract cases than in other typical specific performance cases such as sales of land. This means that an equitable defense may cut considerably into the promisee's expectation interest.

B. Equitable Defenses as a Means of Compromise

In many cases, an equitable defense is not just a choice between specific and substitutional methods of protecting the promisee's expectations; it is also a decision not to protect the expectation interest. Because of defects in the damage remedy, an equitable defense produces a compromise that denies the promisee the full benefit of the bargain, while still affording some compensation for loss.¹⁴⁹

This function of equitable defenses is easiest to see when the

court was able to announce a new standard for future cases (that certain provisions will not be enforced) without upsetting the promisee's expectations. D. DOBBS, *supra* note 3, § 2.4, at 48-49. In one sense, this view is similar to the explanation set out later in this Article under the heading of "acoustic separation." See *infra* subpart II(C). It is justified, if at all, as a strategy for reconciling decision and conduct rules, and not on the basis of functional differences between specific performance and damages.

147. Materials on unconscionability are collected *supra* at note 23.

148. See, e.g., *Eastern Rolling Mill Co. v. Michlovitz*, 158 Md. 486, 145 A. 378 (1929); RESTATEMENT (SECOND) OF CONTRACTS § 360 comment b & illustration 4 (1981); J. CALAMARI & J. PERILLO, *supra* note 4, § 16-3, at 664; E. FARNSWORTH, *supra* note 23, § 12.6, at 859.

149. Professor Yorio defends equitable defenses as a source of remedial flexibility. See E. YORIO, *supra* note 2, §§ 4.3, 4.5.2. I agree with his observations on the effect of equitable defenses, but I prefer a more direct solution. See *infra* text accompanying notes 208-210.

principal feature of the case is an unequal exchange of value brought about by the promisor's unilateral mistake or general lack of sophistication. In this situation there is no inherent difference between specific and substitutional remedies. Either way, enforcing the bargain will impose a hardship on the promisor. The possibility of compromise arises because damages often do not meet their stated goal of enforcing the promisee's bargain.

Panco v. Rogers, the case of the elderly carpenter, is an example.¹⁵⁰ Mr. Panco thought he was selling his home for \$12,500, but signed an agreement with the Rogers that stated a price of \$5500.¹⁵¹ Specific performance would hold Mr. Panco to the bargain (\$5500). An equitable defense leaves the Rogers with a damage remedy that is supposed to protect their expectancy. But for reasons explained below, damages may not give the Rogers the full value of their bargain. In these circumstances, a decision to deny specific performance may be a sign that the court does not find the promisee's expectancy claim compelling. But if so, an equitable defense is not the right solution. Rather than confusing the issue with references to the moral character of equity, courts should reconsider why and when the expectation interest deserves protection.

1. *The Bargain Principle*.¹⁵²—The first rule of contract enforcement is that the remedy for breach should put the promisee in the position she would have been in if the promisor had performed: she is entitled to the expected benefit of her bargain.¹⁵³ The promisee can pursue alternative remedies based on reliance (the loss resulting from the transaction) and restitution (the benefits conferred on the promisor), but these usually are viewed as incidental to the primary

150. See 19 N.J. Super. 12, 87 A.2d 770 (Ch. Div. 1952) (discussed *supra* at text accompanying notes 6-15).

151. *Id.* at 16, 87 A.2d at 771.

152. This term is borrowed from Professor Eisenberg, who uses it to describe the rule that a valid contract is enforceable by remedies that give the promisee her expectancy. See Eisenberg, *supra* note 21, at 742.

153. RESTATEMENT (SECOND) OF CONTRACTS § 344(a) & comment a, § 347 & comment a (1981); J. CALAMARI & J. PERILLO, *supra* note 4, § 14-4; 5 A. CORBIN, *supra* note 4, § 992; E. FARNSWORTH, *supra* note 23, § 12.1, at 840-42; 11 S. WILLISTON, *supra* note 5, § 1338, at 198; Eisenberg, *supra* note 21, at 744-45; Farnsworth, *supra* note 4, at 1147-49. Some courts make an exception to the normal measure in certain land-sale cases when the seller is unable to perform as a result of a defect in her title. The buyer's remedy is limited to restitution and compensation for expenses. But a seller who deliberately breaches a land-sale contract is likely to be held to expectancy damages. See J. CALAMARI & J. PERILLO, *supra* note 4, § 14-30; 5 A. CORBIN, *supra* note 4, §§ 1097-98; D. DOBBS, *supra* note 3, § 12.8, at 833-36; C. MCCORMICK, HANDBOOK ON THE LAW OF DAMAGES §§ 177-79 (1952); 3 G. PALMER, *supra* note 22, § 15.7, at 421-26.

remedy, which compensates lost expectations.¹⁵⁴ Reliance and restitution remedies are most likely to come into play when an expectancy claim fails for want of proof. If the contract is enforceable and an expectancy remedy is feasible, the promisee can demand the full value of her bargain.

The alternative to full enforcement is rescission, if the promisor can establish an appropriate defense.¹⁵⁵ According to traditional views of rescission, the promisor's contract obligation is expunged and the promisee has no further basis for a compensatory claim, even to the extent of losses suffered in reliance.¹⁵⁶ The only avenue remaining to the promisee is a restitution claim for benefits con-

154. On reliance and restitution as alternative measures of recovery, see RESTATEMENT (SECOND) OF CONTRACTS §§ 344(b), (c), 349, 373 (1981); J. CALAMARI & J. PERILLO, *supra* note 4, §§ 14-9, 15-5; 5 A. CORBIN, *supra* note 4, §§ 1031-35, 1104; D. DOBBS, *supra* note 3, § 12.1, at 787, 791-95; E. FARNSWORTH, *supra* note 23, § 12.1, at 842-44, § 12.16; Fuller & Perdue, *supra* note 28, at 53-57 (identifying contract interests and urging greater attention to reliance).

Although the promisee can elect to recover on the basis of reliance or restitution, the value of her expectancy is a limit on reliance claims. A restitution measure sometimes exceeds the expectancy measure, but it is not likely to include profits the promisor derived from breach. The problem of losing contracts is discussed in RESTATEMENT (SECOND) OF CONTRACTS §§ 349 comment a, 373(2) & comments b, c, & d (1981); 5 A. CORBIN, *supra* note 4, §§ 1033, 1113; E. FARNSWORTH, *supra* note 23, § 12.16, at 928, § 12.20, at 931-35; 1 G. PALMER, *supra* note 22, §§ 4.3, 4.4; Farnsworth, *supra* note 4, at 1175-85. On restitution of a breaching party's profits, see 1 G. PALMER, *supra* note 22, § 4.9(a), (b); Dawson, *supra* note 140, at 186-89 (favoring a profit measure). *Cf. supra* note 109 (efficient breach).

155. The origin and nature of the rescission remedy are discussed *supra* at note 24 and in the sources cited there.

156. See H. BLACK, *supra* note 24, § 704; G. CLARK, *supra* note 5, § 278, at 408 & n.6; E. FARNSWORTH, *supra* note 23, § 9.9; 2 G. PALMER, *supra* note 22, § 7.6, at 129-30 (impossibility), § 12.8(a), at 603-04 (mistake in assumption); E. YORIO, *supra* note 2, § 4.5.2, at 97; 13 S. WILLISTON, *supra* note 5, § 1542, at 71; Perillo, *Restitution in the Second Restatement of Contracts*, 81 COLUM. L. REV. 37, 40 (1981) (noting change in the second Restatement). The main source of protection against reliance loss is a defense based on detrimental change of position. See 3 H. BLACK, *supra* note 24, § 618; G. CLARK, *supra* note 5, § 294, at 425; D. DOBBS, *supra* note 3, § 4.6, at 280-81; 13 S. WILLISTON, *supra* note 5, § 1595.

There is no good reason why courts should not allow an affirmative reliance claim; the obstacle is a conceptual one, that rescission nullifies the basis for a compensatory claim. A number of scholars over the years have argued for greater attention to reliance loss in connection with rescission. See, e.g., Fuller & Perdue, *The Reliance Interest in Contract Damages* (pt. 2), 46 YALE L.J. 373, 379-86 (1937); Hudec, *Restating the "Reliance Interest,"* 67 CORNELL L. REV. 704, 716-17 (1982); McClintock, *supra* note 59, 478-80 (permitting recovery of reliance losses enables courts to allow rescission for negligent unilateral mistakes); 2 G. PALMER, *supra* note 22, §§ 7.6(a), 12.8(b); 3 *id.* § 15.9; Perillo, *supra*, at 38-42 (discussing the Restatement's categorization of reliance and restitution remedies); Sharp, *Promissory Liability* (pt. 2), 7 U. CHI. L. REV. 250, 267 (1940) (reliance relief should not be confined to cases of mutual mistake). Some also advocate loss sharing, particularly in the context of impossibility. See, e.g., Harrison, *supra* note 21; Note,

ferred on the promisor, based on the independent ground of unjust enrichment.¹⁵⁷ In fact, courts are not always so rigid; they occasionally require the promisor to compensate the promisee for out-of-pocket or preparatory expenses as a condition of rescission.¹⁵⁸ But reliance damages have not emerged as a regular alternative when full enforcement will produce a harsh result. The choice is usually between an expectancy remedy if the contract is enforceable and restitution if it is not.¹⁵⁹

Apportioning Loss After Discharge of a Burdensome Contract: A Statutory Solution, 69 YALE L.J. 1054 (1960).

The second *Restatement* seems at times to encourage flexibility in the adjustment of rights following rescission. In case of discharge for mistake or impossibility, the court is told to "grant relief on such terms as justice requires including protection of the parties' reliance interests." RESTATEMENT (SECOND) OF CONTRACTS §§ 158(2), 272(2) (1981). But comments elsewhere suggest that the drafters did not approve a general practice of compensating reliance in connection with rescission. See *id.* § 377 comment b (restitution following discharge for impossibility does not include compensation for expenditures in reliance); Perillo, *supra* at 39-40 (noting inconsistency in the *Restatement*).

157. See RESTATEMENT (SECOND) OF CONTRACTS § 376 comment a, § 377 comment a (1981); D. DOBBS, *supra* note 3, § 4.3, at 254-55. The *Restatement* defines restitution in terms of benefit conferred on the other party (the promisor, in the context of this Article). See RESTATEMENT (SECOND) OF CONTRACTS §§ 344(c), 370 & comment a, 371 (1981). Cf. RESTATEMENT OF RESTITUTION § 1 & comment e (enrichment not always essential). The term "benefit" is capable of broad interpretation, so that restitution sometimes merges into protection of reliance interests. For example, expenses the promisee incurs in preparation for performance of her part of the contract can be characterized as a "bargained-for" benefit to the promisor. See RESTATEMENT (SECOND) OF CONTRACTS § 370 & comment a (1981); 1 G. PALMER, *supra* note 22, § 1.8; 2 *id.* § 6.3(a), at 18-21 (contracts unenforceable under the statute of frauds); Fuller & Perdue, *supra* note 28, at 71. But as long as the emphasis is on benefit, restitution theory does not reach the full range of consequential losses that might be compensated under a reliance measure of damages. See RESTATEMENT (SECOND) OF CONTRACTS § 370 comment a (1981); 2 G. PALMER, *supra* note 22, § 7.6(a), at 130-31; Fuller & Perdue, *supra* note 28, at 71-75, 78 (distinguishing between "essential" reliance and "incidental" reliance). For a helpful discussion of the elements of reliance loss, see Hudec, *supra* note 156, at 719-28.

Some writers have questioned the equation of restitution with unjust enrichment. At least in the context of failed contracts, they prefer to conceive of restitution as a wider process of adjustment between parties. See Dawson, *Restitution Without Enrichment*, 61 B.U.L. REV. 563, 569-70, 585-600, 620-21 (1981); Perillo, *supra* note 156, at 38-39 n.17.

158. See, e.g., Board of Regents of Murray State Normal School v. Cole, 209 Ky. 761, 768, 273 S.W.2d 508, 511 (1925) (allowing a contractor to recover expenses when he had erred in calculating a bid); Mutual Life Ins. Co. v. Metzger, 167 Md. 27, 32-33, 172 A. 610, 612 (1934) (requiring insurance company whose clerk made an overcompensation error to compensate a beneficiary for expenses in reliance on the error); R. Zoppo Co. v. Commonwealth, 353 Mass. 401, 406-08, 232 N.E.2d 346, 349-51 (1967) (allowing recovery for preparatory expenses, anticipated profits, and work completed before the contract was rendered impossible); Albre Marble & Tile Co. v. John Bowen Co., 338 Mass. 394, 401, 155 N.E.2d 437, 441 (1959) (requiring defendant to pay plaintiff for all acts performed "in conformity with the specific request of the defendant" in connection with a contract rendered impossible).

159. Occasionally, a court may disregard standard remedial doctrine and shift deliber-

Against this background, equitable defenses provide a rough compromise between full enforcement and rescission. In theory, an equitable defense does not displace the bargain principle because the damage remedy remains intact. But in practice there are several reasons why damages may not fully compensate for the lost value of performance.

The first problem is translating performance into money. In economic terms, all goods and services have substitutes (other goods and services the promisee would be equally happy to obtain).¹⁶⁰ But when market information is scarce or the contract has personal value for the promisee, a court cannot easily identify a substitute and damages may not be accurate.¹⁶¹

These valuation problems are highlighted by the adequacy test, which limits the operation of equitable remedies and defenses to cases in which the court has determined that damages are suspect. A land sale is the least troubling, because there often is an active market. But even in land sales, personal preferences and the scale of the transaction affect the accuracy of expectancy damages.¹⁶² Further, the promisee may run into strategic difficulty in proving the value of her expectancy after opposing an equitable defense. Evidence she offered earlier to show that the contract was not as harsh as the promisor claimed will tend to undercut her claim for loss of bargain.¹⁶³

There are also some doctrinal limits on contract damages. One of these is the rule of *Hadley v. Baxendale*,¹⁶⁴ which limits consequent-

ately from an expectancy measure to a reliance measure. See, e.g., *Sullivan v. O'Connor*, 363 Mass. 579, 588, 296 N.E.2d 183, 189-90 (1973). In *Sullivan*, the court decided that a contract to improve the appearance of the plaintiff's nose was not the sort of bargain that should be enforced in full. Instead, the appropriate remedy was compensation for losses the plaintiff suffered in reliance, including the pain and suffering she endured. *Id.* at 587, 296 N.E.2d at 188-89. See G. GILMORE, *THE DEATH OF CONTRACT* 87-93 (1974) (discussing the "reabsorption" of contract into tort).

160. This concept is qualified in Kronman, *supra* note 38, at 358-61. See also R. POSNER, *supra* note 38, § 1.1, at 4-5 ("the law of demand").

161. See R. POSNER, *supra* note 38, § 4.11, at 117-18; Goetz & Scott, *Efficient Breach*, *supra* note 28, at 568-73; Kronman, *supra* note 38, at 360-63; Linzer, *supra* note 38, at 116-17; Schwartz, *Specific Performance*, *supra* note 23, at 274-77.

162. The traditional assumption that land is unique is sometimes questioned. See E. FARNSWORTH, *supra* note 23, § 12.6, at 860-61 & n.22. But at least in the case of residential property, land often has special subjective value. Further, the purchase-and-sale transaction is likely to be lengthy and personalized. Even if land can be valued, damages may not take account of intangible incidental costs. See D. DOBBS, *supra* note 3, § 12.13, at 861 (discussing vendor's remedies); Laycock, *supra* note 29, at 703-05.

163. In a merged court, the promisee can request alternative remedies, but will have to argue against an equitable defense and for expectancy damages in the same trial.

164. 156 Eng. Rep. 145 (1854).

ial damages to losses that were foreseeable at the time of agreement.¹⁶⁵ This means that if Mr. Panco's breach caused the Rogers a loss not commonly associated with land sales, one aspect of the value of performance (avoidance of that loss) will not be compensated. Another limiting rule places the burden of proof of damages on the promisee and requires that she prove the lost value of the bargain with "reasonable certainty."¹⁶⁶ If the Rogers hoped to profit from some enterprise for which Mr. Panco's land was uniquely suited, they may lose this value because proof of loss is not sufficiently certain.¹⁶⁷

Another pitfall for the promisee is the elasticity of the legal concept of value.¹⁶⁸ The basic measure of contract damages is the value of performance to the promisee, but courts often standardize their calculations in objective terms. Unless the promisee can establish a special valuation (consistent with the rules of certainty and foreseeability), her claim is limited to the difference between market value and contract price.¹⁶⁹ Further, objective measures of value can be

165. See *id.* at 151. The rule began with *Hadley v. Baxendale* and is now well established as a limit on contract damages. See RESTATEMENT (SECOND) OF CONTRACTS § 351 (1981); J. CALAMARI & J. PERILLO, *supra* note 4, § 14-5, at 593; 5 A. CORBIN, *supra* note 4, § 1007; D. DOBBS, *supra* note 3, § 12.3, at 803; E. FARNSWORTH, *supra* note 23, § 12.14, at 912-13; 11 S. WILLISTON, *supra* note 5, § 1356; E. YORIO, *supra* note 2, § 8.3, at 187. The term "foreseeability" does not completely describe the content courts have given this rule. For example, courts may hold that emotional harm is too remote a loss to be compensated in a contract action, even if it was foreseeable. See, e.g., *Valentine v. General Am. Credit, Inc.*, 420 Mich. 256, 260-61, 362 N.W.2d 628, 630 (1984); J. CALAMARI & J. PERILLO, *supra* note 4, § 14-5(b); D. DOBBS, *supra* note 3, § 12.3, at 805-07. Cf. RESTATEMENT (SECOND) OF CONTRACTS § 353 (1981) (emotional harm generally not compensable). Scholars most often explain the rule in terms of risk allocation, viewing it either as a limit on the scope of contractual risk or as an incentive for efficient risk allocation between parties. See, e.g., D. DOBBS, *supra* note 3, § 12.3, at 814-17; R. POSNER, *supra* note 38, § 4.9; E. YORIO, *supra* note 2, § 8.3.3; Farnsworth, *supra* note 4, at 1207-10; Fuller & Perdue, *supra* note 28, at 84-88.

166. See RESTATEMENT (SECOND) OF CONTRACTS § 352 (1981). The certainty requirement is discussed in J. CALAMARI & J. PERILLO, *supra* note 4, § 14-8; 5 A. CORBIN, *supra* note 4, § 1020; D. DOBBS, *supra* note 3, § 12.3, at 802-03; E. FARNSWORTH, *supra* note 23, § 12.15; 11 S. WILLISTON, *supra* note 5, § 1345; E. YORIO, *supra* note 2, § 8.4; Farnsworth, *supra* note 4, at 1210-15; Fuller & Perdue, *supra* note 28, at 373-77.

167. See RESTATEMENT (SECOND) OF CONTRACTS § 352 comment b (1981); J. CALAMARI & J. PERILLO, *supra* note 4, § 14-8, at 601; D. DOBBS, *supra* note 3, § 12.3, at 802; E. FARNSWORTH, *supra* note 23, § 12.15, at 923-24.

168. See generally 5 A. CORBIN, *supra* note 4, § 1004; D. DOBBS, *supra* note 3, § 3.2, at 143-48, § 12.1, at 788-90; 11 S. WILLISTON, *supra* note 5, § 1342.

169. See RESTATEMENT (SECOND) OF CONTRACTS § 344 comment b (1981); J. CALAMARI & J. PERILLO, *supra* note 4, § 14-12; D. DOBBS, *supra* note 3, § 3.2, at 140; E. FARNSWORTH, *supra* note 23, § 12.12, at 902-04; Farnsworth, *supra* note 4, at 1167. In addition to market-based damages, the Uniform Commercial Code allows a disappointed buyer to purchase a substitute and recoup her cover costs. See U.C.C. § 2-712 (cover), § 2-713

stated in different ways. For example, the lost value that results from defects in construction work can be described as either the cost of repair or the loss in market value of the building—with very different results for the promisee.¹⁷⁰

Finally, there is the jury. At least when there are no incidental damage claims, a claim for specific performance is an equitable claim that will be tried before a judge in most courts. A damage claim is a legal claim, in which the promisor is entitled to a jury trial.¹⁷¹ A jury does not have to articulate the reasons for its decision, and when faced with the same facts that establish a fairness defense to specific performance, it may be inclined to resolve doubts about value in favor of the promisor.

Taking into account these constraints on the damage remedy, the effect of an equitable defense may be to deny full enforcement of the promisee's expectation interest, but at the same time to preserve her claim for some compensation for the effects of the breach. The promisee will not receive the full benefit of her bargain. On the other hand, she may get something. She can press her claim for the lost bargain as far as problems of proof and measurement will allow, or she can claim compensation for her losses in reliance on the

(difference between market value and contract price). See J. WHITE & J. SUMMERS, *supra* note 23, §§ 6-3, 6-4.

170. See, e.g., *State Property & Bldgs. Comm'n v. H.W. Miller Co.*, 385 S.W.2d 211, 214 (Ky. App. 1964) (cost of repair or diminution in value, whichever is lower); *Groves v. John Wunder Co.*, 205 Minn. 163, 167, 286 N.W. 235, 237 (1939) (adopting cost of repair standard in case of willful breach); *Peevyhouse v. Garland Coal & Mining Co.*, 382 P.2d 109, 111-13 (Okla. 1962) (diminution-in-value), *cert. denied*, 375 U.S. 906 (1963); *Appalachian Power Co. v. John Stewart Walker, Inc.*, 214 Va. 524, 535-36, 201 S.E.2d 758, 767 (1974) (measure depends on promisee's motive in entering the contract). See also J. CALAMARI & J. PERILLO, *supra* note 4, § 14-29; 5 A. CORBIN, *supra* note 4, §§ 1089-90; D. DOBBS, *supra* note 3, § 12.25; E. FARNSWORTH, *supra* note 23, § 12.13, at 907-08; D. LAYCOCK, *supra* note 3, at 922-29; Farnsworth, *supra* note 4, at 1167-75; Linzer, *supra* note 38, at 134-38; Wolcher, *supra* note 28, at 881-85 (discussing *Groves* and *Peevyhouse*).

According to the second *Restatement*, the promisee normally has a choice between cost of repair and diminution of value. But if the court feels the cost of repair is disproportionate to the value the promisee places on the agreed performance, the promisee is limited to the value measure (unless she can prove a special subjective value). In this way, she may end up with a figure that is less than her personal valuation of the performance. RESTATEMENT (SECOND) OF CONTRACTS § 348(2) & comment c (1981).

171. The right to a jury trial is a complex problem. It is fair to say that if the promisee requests specific performance alone, without supplemental damages, the promisor is not entitled to a jury trial. If the promisee requests damages only, the promisor can demand a jury trial. The mode of trial of a mixed claim for damages and specific performance depends on whether the jurisdiction adopts an "historical" or "dynamic" approach to jury trial. For summaries of jury trial issues and doctrine, see D. DOBBS, *supra* note 3, § 2.6, at 68-81; D. Laycock, *supra* note 3, at 1251-72; 9 C. WRIGHT & A. MILLER, *FEDERAL PRACTICE AND PROCEDURE* §§ 2301, 2302 (1971).

contract.¹⁷²

2. *Limits on the Bargain Principle.*—Viewed in this way, an equitable defense may reflect the court's intuition that the bargain principle is out of place. The supposed basis for a special defense is a moral distinction between law and equity. But the real reason may be that full protection of the expectancy interest is not the promisee's "rightful position."¹⁷³

Protection of contract expectations has been the subject of a continuing debate.¹⁷⁴ The conclusion that contracts create legal duties does not lead automatically to a remedy that compensates disappointed promisees for the lost value of their bargains.¹⁷⁵ Writers on this subject have identified some good reasons for an expectancy remedy, but the reasons for full enforcement are not present in every contract transaction.¹⁷⁶

The best explanation for protection of the promisee's expectation interest is set out in Professor Fuller's classic article on contract interests.¹⁷⁷ Fuller said that an expectancy remedy has no intrinsic justification, but is often the best way to protect against reliance loss.¹⁷⁸ Legal protection against losses incurred in reliance on a

172. See RESTATEMENT (SECOND) OF CONTRACTS § 349 & comment a (1981); J. CALAMARI & J. PERILLO, *supra* note 4, § 14-9, at 603; 5 A. CORBIN, *supra* note 4, § 1033, at 204; E. FARNSWORTH, *supra* note 23, § 12.16, at 928.

173. This phrase is borrowed from Professor Laycock. See D. LAYCOCK, *supra* note 3, at 15.

174. Theoretical discussions of expectancy principle are collected *supra* at note 28. My analysis in this section draws heavily on articles by Professors Eisenberg and Fuller. See Eisenberg, *supra* note 21; Fuller & Perdue, *supra* note 28.

175. Professor Craswell has made this point persuasively, with reference to several theories of contract obligation. See Craswell, *supra* note 142, at 512-14, 517-20. See also Wolcher, *supra* note 28, at 825-29 (a similar analysis).

176. This is a central theme in Professor Eisenberg's article on the bargain principle. See Eisenberg, *supra* note 21, at 748-49, 754, 798-801. Eisenberg identifies four arguments of fairness and efficiency in support of the bargain principle. See *id.* at 745-46; see also *id.* at 787 (justifications for full enforcement of executory bargains). He observes that these arguments are strongest in the case of a contract that was made in a competitive market and has been performed on one side. See *id.* at 786. Away from that setting, they are less persuasive. *Id.* at 746-48. He then develops four "norms of unconscionability" that apply when the market is unreliable and the arguments that support the bargain principle are not applicable. See *id.* at 748-85. While I do not agree in all details with his conclusions, I find his approach very helpful.

Fuller also argued that the justifications for an expectancy remedy lose force outside the context of a "bilateral business agreement" in a competitive market. Fuller & Perdue, *supra* note 28, at 63-66 (contracts distant from the "credit system"); Fuller & Perdue, *supra* note 156, at 396-401 (contracts that are "too social").

177. Fuller & Perdue, *supra* note 28, at 57-66.

178. *Id.* at 61.

contract serves commercial policies that are vital to our society—we have a credit economy, which the law should support by promoting reliance on mutual promises.¹⁷⁹ In a competitive market, the value of performance is a fair surrogate for reliance loss because reliance loss includes the lost opportunity to enter a similar contract with someone else.¹⁸⁰ Actual reliance (at least in the full sense of lost opportunity) may be difficult to prove, so courts use an expectancy measure to approximate reliance loss and to deter breaches that cause reliance loss.¹⁸¹

Professors Goetz and Scott reach a similar conclusion by an economic route.¹⁸² Their ideal remedy is compensation for “prospective net reliance.”¹⁸³ A promise causes the promisee to alter consumption patterns in ways that will be efficient if the promisor performs, but inefficient if the promisor does not perform.¹⁸⁴ The prospective net reliance induced by a promise is the detriment that could result from breach, less the benefit that could result from performance, times a factor representing the promisor’s intention to breach or perform.¹⁸⁵ According to Goetz and Scott, a remedy based on this formula is desirable because it will lead the parties to an optimal level of promissory activity.¹⁸⁶

179. Fuller characterized this as a “juristic reason” for enforcement, as opposed to the simpler “institutional” explanation that credit is pervasive in our economy. *See id.* at 60. The institutional fact of a credit-based economy is not a sufficient explanation because the economic value of promises depends on legal enforcement. *Id.* at 59. The juristic explanation identifies a conscious judicial policy to foster a credit economy, evolved through the interaction of courts with social and economic institutions. *Id.* at 60.

180. The value of forgone opportunities is a real aspect of the promisee’s loss in many cases. *See* Cooter & Eisenberg, *supra* note 28, at 1440-41, 1448, 1456-59; Fuller & Perdue, *supra* note 28, at 55-56; Goetz & Scott, *Basis of Contract*, *supra* note 28, at 1269-70. But it is very difficult to prove outside the context of a perfectly competitive market. Cooter & Eisenberg, *supra* note 28, at 1455; Fuller & Perdue, *supra* note 28, at 60. As a result, damages under a reliance measure normally will be calculated on the basis of out-of-pocket expenses. *See* RESTATEMENT (SECOND) OF CONTRACTS § 349 & illustrations 1-4 (1981) (focusing on expenses in performance or preparation for performance).

181. Fuller & Perdue, *supra* note 28, at 60-63.

182. *See* Goetz & Scott, *Basis of Contract*, *supra* note 28.

183. *See id.* at 1282.

184. *Id.* at 1281.

185. *Id.*

186. *See id.* at 1282-83. I am not convinced that this formula would produce optimal promissory activity. My problem lies with the element of the formula that ties liability to the promisor’s intent to perform. The promisee does not know the promisor’s intentions, and this uncertainty will affect her beneficial reliance and (in a reciprocal exchange) her willingness to transact. Even if the formula were based on objective probability of performance, a risk-averse promisee might be reluctant to do business under this remedial rule.

The authors go on to say that in a competitive market, the formula can be simplified.¹⁸⁷ Detrimental reliance will be roughly equal to the value of performance, because it includes opportunity cost and opportunity cost in a competitive market is the value of a like transaction.¹⁸⁸ Beneficial reliance drops out, because other market opportunities would yield the same benefit.¹⁸⁹ The result: an expectancy measure of damages.¹⁹⁰

Another economic explanation for an expectancy measure of damages relates to the notion of efficient breach.¹⁹¹ Efficient breach theorists are concerned with the impact of remedial rules on the decision to breach or perform. Given a rational promisor, an expectancy measure ensures that breach will be efficient because it forces the promisor to consider the promisee's loss of value.¹⁹² The promisor will breach the contract if but only if a different use of resources has greater value.¹⁹³

There are several reasons why these justifications for an expectancy remedy may not hold true in a particular case. First, any argument that rests on the equation of expectancy and reliance requires an active market.¹⁹⁴ When the subject of the contract cannot be duplicated easily in a competitive market, it is no longer fair to assume that opportunity costs are equal to the value of the promised per-

187. *See id.* at 1284-86.

188. *Id.* at 1284.

189. *Id.*

190. *Id.*

191. Materials on efficient breach are collected *supra* at note 109. The efficient breach argument relates specifically to an expectancy remedy in the form of damages. Specific performance may or may not be acceptable as an alternative remedy, depending on the transaction costs of negotiating around specific performance. *See supra* notes 111-116 and accompanying text. But damages must be governed by an expectancy rule to ensure that the promisor will internalize the costs of breach to the promisee.

192. Cooter & Eisenberg, *supra* note 28, at 1463.

193. *Id.* at 1462-63. *See also* A. POLINSKY, *supra* note 28, at 31-32; R. POSNER, *supra* note 38, § 4.8, at 108; Cooter & Eisenberg, *supra* note 28, at 1463; Farber, *Contract Law and Modern Economic Theory*, 78 Nw. U.L. REV. 303, 321 (1983) (neoclassical model).

194. *See* Fuller & Perdue, *supra* note 28, at 62-63, 65-66. *See also* Cooter & Eisenberg, *supra* note 28, at 1451-55 (ultimately preferring an expectancy remedy for other reasons); Eisenberg, *supra* note 21, at 790 (suggesting that the buyer should bear the cost of uncertainty); Goetz & Scott, *Basis of Contract*, *supra* note 28, at 1284 (assuming a well-organized market).

Professor Eisenberg links the bargain principle to a competitive market in several other ways. First, there is a general perception that a price set by private agreement in a competitive market is fair, which may not hold true in other settings. Second, the policy of encouraging credit transactions is a market-oriented policy. Third, the function of privately agreed prices in moving resources to their highest use depends on a competitive market. Eisenberg, *supra* note 28, at 749-50.

formance. In these cases, expectancy is not a reliable surrogate for reliance.

Second, arguments for an expectancy remedy depend on the integrity of the choice reflected in the contract.¹⁹⁵ The connection between expectancy and reliance breaks down when lack of information or cognitive defects undermine the assumption that the agreed price is the best evidence of value. If the price set for a promise is too low (due to the promisor's mistake or disability), expectancy is not equivalent to opportunity cost, because no like contracts were available. Deals with deaf carpenters who do not read their contracts are not fungible.

Further, the expectancy measure is difficult to defend in terms of efficient breach when the bargain is affected by cognitive or informational defects. Efficient breach theories assume that parties to a contract are fully informed and rational, and that their agreement is an accurate reflection of the values they placed on the subject matter.¹⁹⁶ If the promisor erred and priced performance too low, the terms of the exchange are no longer good evidence of the value each party places on the resources involved, and expectancy damages do not ensure that the resources will be allocated to their highest valued use.¹⁹⁷

There are other incentive reasons for enforcing contract obliga-

195. Eisenberg addresses this problem in his norms of unconscionability—particularly the norms of “transactional incapacity,” Eisenberg, *supra* note 21, at 763, and “unfair persuasion,” *id.* at 765-66. See also Farber, *supra* note 193, at 322-39 (discussing newer economic models that acknowledge the effects of imperfect information); Kronman, *Paternalism*, *supra* note 21, at 786 (moral justifications for relief from poor judgment when there are defects in the promisor's reasoning process); Sunstein, *supra* note 21, at 1166 (flaws in private choice).

196. Economic models of efficient breach rest on the assumption (implicit or explicit) that the parties understand their positions and will engage in a rational calculation of costs and benefits (with appropriate adjustment for uncertainties). See, e.g., A. POLINSKY, *supra* note 28, at 31-33; R. POSNER, *supra* note 38, § 4.8, at 106-08 (general economic principles after breach); Goetz & Scott, *Efficient Breach*, *supra* note 28, at 563-65. See also R. POSNER, *supra* note 38, § 1.1, at 3-4 (assumption of rational choice); Eisenberg, *supra* note 21, at 763-66, 775 (situations in which lack of information and sophistication undermine the efficiency of private exchange).

197. When the price is an error, we do not know from the parties' agreement who values the subject matter more. The promisee's expectancy is likely to be inflated by the error beyond what is necessary to deter inefficient breach. And it is possible to imagine a case in which an expectancy measure could lead to inefficient performance. For example, assume the court can estimate a market value for Mr. Panco's house, in the amount of \$10,000. Mr. Panco (who is ready to sell) places a personal value of \$9000 on the house. The Rogers value the house at \$8000, and are delighted to buy for the price of \$5500 stated in the contract. Mr. Panco will have to pay damages of \$4500 to keep the house (the excess of market value over contract price). In these circumstances he will perform, although he values the house more than the Rogers value it. If transactions

tions despite an error in valuation, but these do not require an expectancy remedy. Assuming remedial rules can improve conduct, a rule holding promisors liable for breach may induce them to obtain better information and watch for mistakes.¹⁹⁸ This objective, however, can be accomplished by holding promisors liable for losses caused by their promises.¹⁹⁹ Further, promisors who suffer from cognitive and informational disadvantages are probably outside the range of incentive rules. They may not know of the rule, and if they do there may not be much they can do about it.

Apart from utilitarian and economic reasons for an expectancy measure, some would say promisors should be held to their contracts on moral grounds. But even if one believes that a promise made according to prevailing conventions is morally charged in a liberal society, it does not follow that the promisor is bound to compensate the promisee for the lost benefit of the bargain. It may be equally consistent with a liberal order to hold the promisor liable for harm she caused by making the promise.²⁰⁰

Thus in certain cases—those that are distant from a competitive market and those in which the parties are not fully informed and rational actors—there is no affirmative justification for an expectancy remedy. In these cases, the court can temper the effects of a hard bargain without serious harm to other ideals. The promisee's expectation of profit is not a fact the court must take into account; it is a function of law, which should not be maintained at the prom-

were costless the house would find its way to a third party who values it at \$10,000 or more, but under real conditions transaction costs may slow or curtail the process.

198. See, e.g., R. POSNER, *supra* note 38, § 4.4 (suggesting that a seller may have access at lower cost to information that could help to avoid mistake), § 4.5 (impossibility); Kronman, *Mistake*, *supra* note 21, at 5-8 (mistake).

199. Professor Kronman and Judge Posner have identified three broad economic functions of contract law: to enforce agreed allocations of risk; to provide default rules that will decrease the costs of exchange; and to discourage carelessness and other inefficient behavior in the process of exchange. The first two facilitate value-maximizing exchange, while the third prevents detrimental reliance on ill-considered promises. A. KRONMAN & R. POSNER, *supra* note 64, at 4-5.

When the contract does not represent a rational and informed choice on both sides, the exchange may not maximize wealth. Thus, the only remaining justification for enforcement is the third, deterrent goal of contract law, which does not necessarily require full enforcement of the bargain.

200. See Craswell, *supra* note 142, at 517-20 ("[a]ny damage measure is consistent with the ideal of individual autonomy, as long as it is adopted solely as a default rule, since any default rule expands the promisor's options"); Wolcher, *supra* note 28, at 829 ("different remedies allow different, but not necessarily better or worse, opportunities to choose").

isor's expense when supporting policies do not apply.²⁰¹

At the same time, it is important to protect the promisee's reliance interest. A risk of uncompensated loss will discourage transactions in general unless the risk is limited to a predictable set of circumstances. Concern for the security of transactions may be strongest in an active market, but individualized transactions also have social and economic functions that merit legal protection. Nor is the problem confined to transactions in which both parties are informed and rational. Cognitive and informational defects may not be evident to the promisee, and it is difficult to define them in a way that will allow promisees to spot and avoid risky transactions. Moreover, concern for Mr. Panco does not justify a rule that will discourage transactions with deaf carpenters.²⁰²

Another reason to protect the promisee's reliance interest is that to the extent the promisor is aware of remedial rules, legal responsibility for the promisee's losses may encourage self-protection.²⁰³ Reliance damages cannot always be supported on this ground. If there are palpable defects in the promisor's valuation, the promisee is both the better risk-avoider and the party who ought to bear the loss.²⁰⁴ But when the promisee has no reason to know of the problem, imposing liability for loss caused by a misjudged promise may create desirable incentives for care.

Finally, it is just to require compensation for reliance loss. At least to this extent, moral theories of contract obligation are persuasive. A promise made according to established conventions invites reliance, and if the promisee has in fact relied in a reasonable way, her loss should be corrected.²⁰⁵

201. See Fuller & Perdue, *supra* note 28, at 57-60 (distinguishing "psychological" and "institutional" explanations for an expectancy remedy from "juristic" explanations).

202. See Dawson, *supra* note 21, at 264; Epstein, *supra* note 20, at 304-05.

203. See *supra* notes 198-199 and accompanying text.

204. See Kronman, *Mistake*, *supra* note 21, at 6-8.

205. Scholars writing from several different perspectives have assumed that it is wrong to cause another harm by breaking a promise. See P. ATIYAH, PROMISES, *supra* note 28, at 64-69, 177-202; C. FRIED, *supra* note 28, at 16-17; Barnett, *supra* note 72, at 306-09; Fuller & Perdue, *supra* note 28, at 54, 56.

As a complete theory of contract obligation, reliance runs into problems of circularity. Not all reliance results in liability; it must be invited, or justifiable. This leads to the question of when reliance is invited or justifiable, which is deeply entangled with legal definitions of duty. See Barnett, *supra* at 274-76; Craswell, *supra* note 142, at 498-501. Nevertheless, with the aid of established conventions, it is possible to identify at least a core area in which one person's broken promise can be said to cause another's reliance loss. See P. ATIYAH, PROMISES, *supra* note 28, at 64-66.

Some consequentialists might be indifferent to this conclusion, except insofar as breaking promises is an activity that should be deterred because it is likely to produce

3. *Is an Equitable Fairness Defense the Right Solution?*—The circumstances that support an equitable defense correspond in two ways to the settings in which the reasons for an expectancy remedy lose force. First, the transaction is likely to have taken place outside a competitive market. This is due in part to the traditional rule that specific performance is not available when damages are adequate.²⁰⁶ Usually the reason why damages are unsatisfactory is that the subject matter of the contract cannot be duplicated in an active market.

Second, the facts that make out an equitable defense suggest that defects in private choice have resulted in an imperfect expression of value. Typically the promisor is unsophisticated and therefore unlikely to have perfect information for calculation of value. Often there is an identifiable mistake that makes the gap in information clear. A low price confirms that the contract is not the result of rational interaction. It may seem tautological to rely on a discrepancy in price: a low price proves the choice was defective, and a defective choice proves the price is not a correct statement of value.²⁰⁷ But I believe the price is a useful reference. A court cannot fix a universal “value” because value depends on personal preference. But it can tell when an agreed price is very far removed from normal value, for no good reason.

Thus the compromise function of an equitable defense has some support in terms of limits on the bargain principle. Courts may have isolated a type of case in which there are no compelling reasons for an expectancy remedy, but there are reasons to protect against reliance loss. In response, they deny specific performance and limit the promisee to a damage remedy that will not fully compensate lost expectations.

An equitable defense, however, is not an effective way to address faults in the bargain principle. Its impact on the promisee's expectation interest is indirect and fortuitous; in some cases proof of the value of performance is fairly complete, while in others both expectancy and reliance losses are uncertain. Further, the rhetoric of equitable defenses skews analysis by suggesting that the contract obligation is unfair, when the problem is that full enforcement is

more harm than benefit. See Alexander, *supra* note 97. But for others, infliction of harm through a breach of promise creates a duty of compensation. See P. ATIYAH, PROMISES, *supra* note 28, at 192; Fuller & Perdue, *supra* note 28, at 55. See also Epstein, *supra* note 96.

206. See *supra* notes 39-40 and accompanying text.

207. See *Seymour v. Delancey*, 3 Cow. 445, 504-37 (N.Y. 1824), in which a considerable number of judges were impaled on the horns of this dilemma.

unfair.²⁰⁸

There is no good reason why courts cannot address the shortcomings of the bargain principle directly. Courts should define an area of cases in which reliance, rather than expectancy, is the correct remedial goal. The choice of remedy should correspond to the reasons for an expectancy remedy and the circumstances in which those reasons give way.

If courts accept the possibility of an alternative measure of damages, the fairness defense can be a useful point of reference. Its common features are: (1) an individualized transaction, (2) an exchange that is removed from the competitive market by special characteristics of the subject matter, or by defective market conditions, (3) a promisor who lacked general or specific information (in other words, one who was unsophisticated or made a unilateral mistake) and (4) a price that is perceptibly less than the value most people would place on the promise. When these conditions are present, and the court is reasonably confident that it can compensate reliance loss,²⁰⁹ the remedy should shift from expectancy to reliance.²¹⁰

C. *Acoustic Separation*

So far, my explanations for equitable defenses have focused on remedial problems. Some versions of the fairness defense are related to differences between specific and substitutional relief. Others are rough compromises, which indicate that damage remedies need refinement.

Apart from these remedial issues, equitable defenses may serve

208. See Eisenberg, *supra* note 21, at 744, 798 (distinguishing between the existence of obligation and the extent of enforcement).

209. The weakest link in this proposal is the court's ability to compensate reliance loss. Reliance can take many forms, some of which are subtle and difficult to measure. See 3 G. PALMER, *supra* note 22, § 15.9, at 441-42; R. POSNER, *supra* note 38, § 4.8, at 109-10; Fuller & Perdue, *supra* note 28, at 60; Patterson, *supra* note 29, at 879-80. As a result, the reliance remedy will not be a perfect one. On the other hand, there are cases in which the court can see that the promisee has not changed her position substantially, beyond a documented amount of out-of-pocket expense. See, e.g., *Panco v. Rogers*, 19 N.J. Super. 12, 20-21, 87 A.2d 770, 774 (Ch. Div. 1952) (sellers discovered their mistake immediately, notified buyers and offered to reimburse buyers' expenses). And the court can fortify the reliance remedy by relaxing the requirement of certainty in proof. See *Van Wagner Advertising Corp. v. S & M Enters.*, 67 N.Y.2d 186, 195-96, 492 N.E.2d 756, 761, 501 N.Y.S.2d 628, 633 (1986) (defendant who opposed specific performance was estopped from arguing that damages were conjectural).

210. Several authors have suggested that the reliance measure of damages is appropriate when there are grounds for an equitable defense to specific performance, or in other cases in which an expectancy remedy is excessive. See 2 G. PALMER, *supra* note 22, § 12.7, at 599-600; Fuller & Perdue, *supra* note 156, at 379-82.

a third function: to accommodate conflicting values.²¹¹ Part I suggested that the legal and equitable models of contract enforcement correspond to different substantive values, as well as different formal approaches to law. If so, courts may be using the equitable defenses to pursue both sets of values at once. Equitable defenses provide an opportunity to do this by creating a condition of "acoustic separation" in contract law.

1. *The Concept of Acoustic Separation.*—Acoustic separation is an idea developed by Professor Meir Dan-Cohen in his observation of criminal law.²¹² According to his analysis, laws have two functions. They provide "conduct rules" to guide private actors, and "decision rules" to guide officials who apply the law, after the fact, to the conduct of others.²¹³ The justifications for legal rules as conduct rules lie in policies about desirable conduct by members of society.²¹⁴ The justifications for legal rules as decision rules lie in policies about imposing punishment or liability on individuals.²¹⁵ We are accustomed to think that directions for conduct and directions for decisions in response to conduct must coincide in a single rule. If norms relating to conduct conflict with norms related to decisions, one set of norms (or both) must give way.²¹⁶

Acoustic separation raises the possibility that the conduct and decision functions of legal rules can be separated. The term acoustic separation describes a legal environment in which decision rules are disclosed only to official decisionmakers, and not to the public.²¹⁷ In a condition of perfect acoustic separation, decision rules might differ in substance from the conduct rules they enforced.²¹⁸

211. This explanation differs in nature from those set out in the previous two subparts of the Article. In each of those subparts, I suggested that what purports to be a fairness defense based on "hardship" may conceal other motives. Courts may be denying equitable relief on the basis of unstated differences between damages and specific performance. In this subpart, I accept the rhetoric of the fairness defense and assume that it embodies values that conflict with those expressed in legal defenses.

212. See Dan-Cohen, *supra* note 37.

213. *Id.* at 625-34. See also J. RAZ, *THE CONCEPT OF A LEGAL SYSTEM* 147-56 (2d ed. 1980) (duty-imposing laws and sanction-imposing laws). Conduct and decision are not completely satisfactory terms because both describe decisions: the citizen's decision to act and an official's subsequent decision to attach particular legal consequences to the citizen's action. I will continue to use the terms conduct and decision in the text, although they cause difficulty at certain points.

214. Dan-Cohen, *supra* note 37, at 130.

215. *Id.* at 631.

216. *Id.*

217. See *id.* at 630.

218. *Id.*

For example, a conduct rule might forbid certain behavior, while a more lenient decision rule allowed judges to withhold sanctions in appealing cases. From the point of view of a governing authority overseeing the legal system, acoustic separation would allow the authority to pursue separate policies that are incompatible within a single rule.²¹⁹

There is no perfect acoustic separation in the real world,²²⁰ but there may be conditions of partial acoustic separation, in which conduct rules and decision rules diverge.²²¹ Dan-Cohen has identified a number of plausible examples in criminal law. He also suggests that courts can foster acoustic separation through what he calls "strategies of selective transmission."²²²

219. *See id.*

220. *Id.*

221. *Id.* at 633-34. Partial acoustic separation can occur any time certain normative messages are more likely to be understood by officials than by the public. *Id.*

222. *See id.* at 634-48. Dan-Cohen's article is not an unqualified endorsement of selective transmission, either in general or in the criminal context from which he draws his illustrations. He thinks it is possible, at least in some circumstances, to maintain separate conduct and decision rules without undermining the "rule of law." *Id.* at 668. But he warns that both the utility and the moral acceptability of selective transmission depend on the manner and context of its application. Moreover, he admits that the idea is distasteful from the perspective of those who are governed by law. *See id.* at 665-77. For criticism, see Shapiro, *In Defense of Judicial Candor*, 100 HARV. L. REV. 731, 744-47 (1987); Singer, *On Classism and Dissonance in the Criminal Law: A Reply to Professor Meir Dan-Cohen*, 77 J. CRIM. LAW & CRIMINOLOGY 69 (1986).

Professor Gerald Postema's book on the jurisprudence of Jeremy Bentham provides an interesting parallel. G. POSTEMA, *BENTHAM AND THE COMMON LAW TRADITION* (1986). Postema attributes to Bentham a vision very similar to Dan-Cohen's model of acoustic separation. *See id.* at 405-08. In Bentham's design (as interpreted by Postema), law is embodied in a fixed, clear, and comprehensive code. *Id.* at 405. At the point of adjudication, however, judges decide cases by direct reference to the principle of utility. *Id.* at 405-06. The code enters into the judge's utilitarian calculus insofar as it generates private expectations. However, the code is not treated as determinative in decision making. Although judges' decisions would be publicly announced, they would have no precedential value and therefore would not alter the conduct rules of the code. *See id.* at 403-08. In this way, says Postema, "Bentham's code appears Janus-faced. It presents different aspects depending on whether one views it from the market-place or from the bench." *Id.* at 449. Under Bentham's dual system (if it worked as Bentham supposed), the code would offer certainty, while the adjudication would avoid the disutilities of fixed rules.

Postema concludes with a powerful argument that Bentham's system is both unworkable and wrong. *Id.* at 453-64. On the practical question, Postema is certainly right that decisions cannot be isolated systematically from conduct rules (especially when adjudication is publicly announced, as Bentham insisted it must be). *Id.* at 453-57. Nevertheless, I believe that there are areas of acoustic separation in law that permit a discrepancy between conduct and decision rules. *See infra* section II(C)(2).

Postema also suggests that the division of adjudication and law violates a "moral demand, a requirement of fairness or perhaps 'integrity.'" G. POSTEMA, *supra*, at 457. I agree that a system in which conduct and decision rules diverge is morally imperfect.

Dan-Cohen described selective transmission in terms of substantive goals of the legal system: conduct rules and decision rules may diverge when social objectives conflict with notions of individual justice.²²³ The same concept is useful in considering problems of form.²²⁴ In other words, a governing authority might conclude that it is best for citizens to act according to determinate rules, but that officials who apply law retrospectively should be guided by less determinate standards.²²⁵ In a condition of acoustic separation, the authority could use each formal mode to its best advantage.

There are several reasons why the authority might choose to present law to citizens in the form of rules. Rules are effective for deterrent purposes because their command is understandable.²²⁶

But as I will explain, I am willing in some settings to compromise integrity in the interest of utility and justice. See *infra* notes 257-264 and accompanying text.

Postema's final argument is difficult to set aside. He points out that in the system Bentham proposes, the public is virtually foreclosed from an active role in shaping the law. See G. POSTEMA, *supra*, at 462. If adjudication is kept separate from law-making, and has no prospective impact on conduct rules, there will be no occasion or incentive for private parties to debate the law in terms of public good. See *id.* Parties to adjudication will confine their arguments to retrospective adjustment between parties. As a result, public participation in law-making will be limited to passive functions of review and recall. See *id.* at 459-62. The same criticism applies to acoustic separation, to the extent that legal argument in litigation is directed to rules that operate only as decision rules.

This is an important argument. The best answer I can give is that this Article addresses selective transmission on an occasional rather than a systemic basis. The type of selective transmission discussed here will not result in a general exclusion of reasoned argument from adjudication.

223. See Dan-Cohen, *supra* note 37, at 632-34 ("The law faces a hopeless trade-off between the competing values of deterrence and compassion (or fairness).").

224. The formal version of selective transmission stands up better than its substantive counterpart to some lines of criticism. When there is a substantive gap between conduct and decision rules, the published rule may appear unjust to citizens because it omits values that are reflected in an undisclosed decision rule. See Singer, *supra* note 222, at 90. This problem does not disappear when conduct and decision rules diverge in form, but it may be less severe. Citizens may agree that rules are necessary to govern conduct and accept that the published law is as perfect as it can be in the form of a rule.

225. As described earlier, I consider a rule to be a direction in neutral, determinate terms that dictates the consequences of certain facts without the need for normative evaluation. A standard states a norm, which the decisionmaker must apply directly to particular cases as they arise. See *supra* notes 82-85 and accompanying text.

In defining rules as I do, I am assuming that language can constrain decisions, at least in a core area of understanding. See Schauer, *supra* note 82, at 520-32. I am assuming also that legal rules can and do have some content that is referable solely to the social institution of law, without the need for further moral assessment by the law-applier. See J. RAZ, *supra* note 82, at 37-52.

226. See Ehrlich & Posner, *supra* note 82, at 262 (noting also that rules are less likely than standards to chill desirable conduct); Schlag, *supra* note 82, at 384. There are counterarguments, to the effect that standards are better deterrents because rules allow actors to come closer to the line of prohibited conduct. See Kennedy, *supra* note 61, at 1695-96; Schlag, *supra* note 82, at 384-85. The weight of such an argument depends on

They also provide a framework for private planning by making life predictable.²²⁷ This is especially true in contract law because contract law provides the background rules for a vital social practice.²²⁸ The clearer the rules, the more accessible the practice will be.

Further, direct application of norms by citizens, without the guidance of a rule, is prone to several types of error. Individual actors may not have the information or objectivity necessary to make an accurate assessment of the consequences of their conduct.²²⁹ Moreover, even if their own calculations are sound, they cannot coordinate their conduct with the conduct of others.²³⁰ The authority, in fashioning a rule, can avoid these errors because it regards conduct from a central position, and because it can coerce a coordinated response.²³¹

The trouble with rules is that they are certain to produce the wrong result in some of the cases they govern. A rule is a generalization: it dictates consequences that must follow whenever certain facts are present. As a result, applications of the rule will be under-inclusive and over-inclusive—they will not always conform to the norm the rule is intended to implement.²³² Yet the authority may conclude that overall, fewer errors will result with a rule than would

whether conduct close to the line should be discouraged or protected in the context at issue.

227. See Powers, *supra* note 82, at 1274; Schauer, *supra* note 82, at 539.

228. See Kennedy, *supra* note 61, at 1697-98; Powers, *supra* note 82, at 1274-76. On the role of legal rules in establishing procedures for private ordering, see H.L.A. HART, *THE CONCEPT OF LAW* 27-28 (1961); Rawls, *Two Concepts of Rules*, 64 *PHIL. REV.* 3, 24-29 (1955) (practice conception of rules).

229. See Alexander, *Pursuing the Good—Indirectly*, 95 *ETHICS* 315, 317-18 (1985); Powers, *supra* note 82, at 1273. *But cf.* Wonnell, *supra* note 131, at 456-57 (describing the daunting informational difficulties of central planning with respect to, say, zinc).

230. See Alexander, *supra* note 229, at 318 (prisoners' dilemmas). Professor Alexander points out that these errors affect individual applications of any consequentialist theory, whether the decisionmaker is pursuing utility, equality, self-interest, or some other goal. *Id.* at 316-17, 318.

231. I am not suggesting that a rule is always the better choice for regulation of conduct. There are good reasons why lawmakers might prefer a standard, particularly when they enter a new field still subject to factual and normative uncertainties. See H.L.A. HART, *supra* note 228, at 121-23. See also Powers, *supra* note 82, at 1279-85 (disutilities of obedience to rules).

At least with respect to exchanges of goods, the argument for rules is especially strong in contract law, because the parties' main object is to plan for future exchange. In a relational setting, a standard may be a better guide for conduct, much in the way that a standard is needed in a developing field of law. *Cf.* I. MACNEIL, *supra* note 42, at 59-70 (discrete and relational norms).

232. See Ehrlich & Posner, *supra* note 82, at 268; Kennedy, *supra* note 61, at 1695-96; Powers, *supra* note 82, at 1280-81; Schauer, *supra* note 82, at 534-35, 539 ("Rules doom decision making to mediocrity by mandating the inaccessibility of excellence.").

occur without the rule where each citizen applied the governing norm directly.

Although a rule may be the right choice from the authority's point of view, there remains a problem of obedience by citizens. Citizens cannot simply obey legal rules. As long as they are rational beings, they must act according to their assessment of reasons for action.²³³ Those reasons include the various benefits of obeying the rule (for example, I may trust my own calculation but mistrust the calculations of others and expect that they will err if they deviate from the rule; therefore, I may follow the rule so that others will follow the rule).²³⁴ But it is not rational for citizens to follow the rule when their own balance of all reasons (including the benefits of a rule) favors a different result. This means that if the authority is to accomplish its goal, it must alter the balance of reasons presented to the citizen. In other words, it must introduce an artificial factor to the citizen's decision.

One way to alter the citizen's reasons for action is to back the rule with a sanction. The rational citizen will still weigh relevant considerations. But the sanction adds a reason that should (if the penalty is calculated correctly) tip the balance in favor of the rule.

A sanction, however, raises other difficulties. To preserve the benefits of the rule, the sanction must apply even in those cases in which the rule is overinclusive. In a criminal case, this means the judge must punish the citizen even if the citizen's action was justified. In a contract case, it means the judge must enforce the con-

233. Others may not agree with this statement. Professor Schauer, for example, has described a range of possible responses to legal rules. At one extreme is rule-based decisionmaking, in which the rule is "opaque": the decisionmaker follows it without considering whether the result it dictates is the best result. She does not look behind the rule to see whether the case before her fits its background justifications, nor does she consult the universe of other reasons for decision. At the other extreme is particularistic decisionmaking, in which the rule is "transparent": the decision maker consults not only the rule but the reasons for the rule and all other reasons relevant to the outcome of the case. If other reasons are persuasive the rule gives way. Between the two extremes are particularistic decisions that acknowledge the values served by obedience to rules ("rule-sensitive particularism") and decisions that give a degree of presumptive or exclusionary force to the existence of a rule. Schauer, *Rules and the Rule of Law* (forthcoming in HARV. J.L. & PUB. POL'Y). See also J. RAZ, *supra* note 82, at 16-19 (exclusionary rules).

I do not intend here to enter into the debate over the authority of law and the duty to obey law. But I do not believe it is possible, from the point of view of the citizen, for a legal rule (as such) to exclude consideration of other reasons for action, including the various reasons for following the rule. The position I find most persuasive is Professor Larry Alexander's. See Alexander, *Law and Exclusionary Reasons*, 18 PHIL. TOPICS 5 (forthcoming 1991).

234. The problem of "contagion" is discussed in Powers, *supra* note 82, at 1271-72.

tract even if the bargain is seriously one-sided. Decisions of this kind impose hardship on the individuals they affect, and they force judges to decide against their own assessment of the right result.²³⁵

Acoustic separation suggests a way for the authority to escape this dilemma, by deceiving citizens about the force of the rule in official decisions. In other words, the authority might hold out to private parties a determinate rule, with implicit or explicit instructions that the rule will be enforced by courts. At the same time, it might provide courts with a less determinate standard that calls for direct application of the underlying norm to particular cases. If this standard can be obscured from public view, it will not affect the weight of the rule in the citizens' calculations. The authority can capture the value of rules at the level of public conduct, but leave judicial decisions open to a broader range of justifications.

2. *Acoustic Separation Applied to Contract Enforcement.*—The distinction between legal and equitable enforcement of contracts creates a condition of partial acoustic separation. Substantive contract law says that contracts are enforceable, subject to standardized defenses. If parties look past the substantive law to remedies, the primary remedial rule says that the promisee is entitled to the value of the bargain (in kind or in money) in case of breach. The equitable fairness defense looks unimportant, because it affects only specific relief and not damages. In fact, the damage remedy often does not enforce the promisee's bargain in full.²³⁶ But to perceive the gap in enforcement, the parties must not only be aware that there are special defenses to equitable relief, but also understand the defects in the damage remedy.

That is unlikely to happen. Remedies are remote from lay understandings of law. Equitable remedies, and the various secondary limitations on damages that make specific performance important, are remoter still. Thus it is possible that the legal model of enforcement serves as the conduct rule for contracting parties, while the fairness defense operates as a hidden decision rule (or as a hidden exception to rule-based decision making).

There is also a temporal separation between the legal rule of enforcement and the equitable fairness defense, which is important

235. See Alexander, *supra* note 233; Alexander, *supra* note 229, at 324-25. The authority might force judges to comply by imposing further sanctions up the ladder of decisionmaking. At some point, however, this will not be feasible and someone will have to depart from the rule, or decide against the balance of reasons.

236. See *supra* text accompanying notes 138-48.

because it affects the conduct of lawyers. Lawyers may not explore the question of remedies fully when they give advice at the stage of transaction. Only after a breach, when decisional issues take on practical importance, will the lawyer penetrate to the decision rule.

The foundation is in place, therefore, for selective transmission of rules governing contract enforcement. With respect to the content of the transmission, legal and equitable defenses fit well into the logic of acoustic separation. There is a correspondence, in both substance and form, between legal and equitable defenses and the conduct and decision functions of law. The legal model of enforcement is conduct-oriented and rule-based. The equitable model is better suited to remedial goals and particularistic decisionmaking.

In an earlier subpart of this Article, I described three values associated with the legal model of contract enforcement—the social utility of a market economy, efficient allocation of resources, and respect for personal autonomy.²³⁷ The first two are distinctly conduct-oriented. Both seek to channel private conduct in ways that promote their conception of social good. Further, these two theories of enforcement are not at all concerned with judicial decisions. This makes them good candidates for selective transmission. A decision to impose sanctions or liability in an individual case is important only to the extent that the outcome of the case will inform future conduct. In a condition of acoustic separation, a decision rule that mitigates the enforcement of contract law would have no impact on utility or efficiency.

To the extent that the legal model of enforcement is driven by a theory of individual autonomy or consent, the case for selective transmission breaks down. Theories of this kind require conduct rules—but their object is to define a sphere of individual rights, rather than to channel conduct. Further, they assume that a promise made voluntarily and according to governing conventions creates a moral obligation from one individual to another. In a system of individual rights and duties there can be only one legal rule, which must apply both to conduct and to subsequent enforcement decisions.

On the legal side, therefore, the value of selective transmission depends on which theory of contract obligation is at work. For those who believe that the binding force of promises is moral and follows from personal autonomy, selective transmission will be unacceptable in contract law. But for those concerned with utility or

237. See *supra* subpart I(A).

efficiency, the objectives of the legal model can be accomplished in conduct rules, and need not be carried over to decision rules.

Turning to the equitable model of enforcement, the values associated with equitable defenses relate to justice between individuals. They are concerned with alleviating the unfair results of particular agreements,²³⁸ rather than creating an environment for commercial exchange. They are retrospective, requiring a degree of altruism or humanity when the promisor's choice turns out to be an error and will cause her substantial loss.²³⁹ They are primarily decisional values rather than conduct values.

If these characterizations are correct, equitable defenses can be understood as a means of harmonizing conflicting values through acoustic separation. Their obscurity permits a division between conduct rules and decisions. The legal model of enforcement tells the public that contracts will be enforced, while the equitable model gives relief from hardship in particular cases. Both models serve desirable ends: one furthers market utility, the other furthers justice. They cannot coexist in one rule, but an equitable fairness defense allows courts to pursue both ends at once.²⁴⁰ This use of equitable defenses—as a device to separate conduct and decision rules—is not consistent with a liberal or libertarian moral theory of contract law, but it is well suited to utilitarian goals.

3. *Is Acoustic Separation Acceptable?*—Acoustic separation can produce a greater combination of justice and utility than would be possible if conduct and decision rules were fully publicized.²⁴¹ On the other hand, it is hard to accept deception as an element of our legal system, even if it serves good purposes.²⁴²

A preliminary question is whether selective transmission is feasible. It is not, in any systematic way. Leaks would occur, and a leak could undermine both the effect of the conduct rule and public con-

238. See *supra* subpart I(B).

239. See *id.*

240. I am not suggesting that the traditional distinction between legal and equitable defenses is a conscious and deliberate use of acoustic separation. At most, courts may be vaguely aware that the obscurity of equitable defenses permits them to give relief without impairing the public perception of security in contract transactions.

241. This discussion assumes the best possible setting, in which conduct and decision rules are promulgated by a legitimate lawmaking authority acting in the best interests of society. This is a large assumption, but I am not ready to discuss the political aspects of acoustic separation.

242. Dean Singer is scandalized. See Singer, *supra* note 222, at 73, 84-87. Professor Shapiro is troubled. See Shapiro, *supra* note 222, at 744-47. Dan-Cohen himself is reluctant. See Dan-Cohen, *supra* note 37, at 665-66, 677.

fidence in the legal system. But these considerations do not rule out more casual forms of selective transmission, in which judges take advantage of various naturally occurring conditions of partial acoustic separation. At least in arcane areas of contract enforcement, these conditions can continue undetected for some time.

Aside from practical problems, selective transmission raises serious questions about the relationship of law and legal decision-makers to those who are governed by law. When a legal system engages in selective transmission, it institutionalizes the esoteric character of law. The whole law is known to some and not to others.²⁴³

This leads to a series of possible objections. First, a system in which part of the law is undisclosed might be open to official abuse.²⁴⁴ The likelihood of abuse, however, depends on the nature of the applicable decision rule. If the hidden decision rule is a rule that can be exploited—for example, a contract is not enforceable if the promisor crossed her fingers—those who know the rules will be able to profit from their position. But when the decision rule is a justified exception to harsh applications of a conduct rule, it is not likely to work to the benefit of officials. An equitable defense based on unanticipated hardship or unilateral mistake is not easy to manipulate.

Even if officials derive no special advantage from selective transmission, a system in which decision rules are reserved to a limited group might be charged with elitism. Someone knows better than the rest of us what is best; otherwise we could be trusted with the whole law.²⁴⁵ But selective transmission is not really an elitist idea. Decision rules are withheld from the public not because those in authority have superior moral judgment, but because their central position enables them to make the law work in the best possible way.²⁴⁶ They can accommodate competing values by dividing the

243. In Professor Dan-Cohen's model of perfect acoustic separation, not only are decision rules screened from the public, but conduct rules are screened from official decisionmakers. Dan-Cohen, *supra* note 37, at 630-31. But in a case of partial acoustic separation, which is the only acoustic separation possible in the real world, decision makers are aware of both conduct and decision rules.

244. See Singer, *supra* note 222, at 85-87.

245. See Shapiro, *supra* note 222, at 745-46; Singer, *supra* note 222, at 95-96. A related argument is that when law deceives those it governs, it insults their dignity and autonomy. In the words of Dr. Joseph Raz, a system of clear and open law is virtuous because it "presupposes that [those it governs] are rational and autonomous creatures and attempts to affect their actions and habits by affecting their deliberations." J. RAZ, *supra* note 82, at 222.

246. See generally Powers, *supra* note 82, at 1268-93 (discussing the utilitarian benefits of three features of law: its centrality, its coercive power, and its formality).

conduct and decision functions of law. Or, by casting conduct rules as rules and decision rules as standards, they can obtain the benefits of rules without the cost of overinclusive applications. In either case, it is their position of authority, rather than their personal characteristics, that justifies secrecy.

The hardest objections to overcome are based on the ideal of the "rule of law."²⁴⁷ It is generally understood that to maintain the rule of law, laws must be open and clear to citizens.²⁴⁸ Selective transmission, by definition, seems to violate that standard. Dan-Cohen addressed this problem at some length when he first set out his ideas on acoustic separation.²⁴⁹ His tentative conclusion was that at least in some circumstances, it is possible to maintain separate conduct and decision rules without serious damage to the values served by the rule of law.²⁵⁰

The greatest obstacle Dan-Cohen encountered as he tried to reconcile selective transmission with the rule of law was its impact on the liberty and autonomy of citizens.²⁵¹ He put the problem this way: a system governed by clear and open laws promotes liberty and autonomy by enabling individuals to plan for pursuit of their

247. See Singer, *supra* note 222, at 98-100 ("The core of the problem with Dan-Cohen's position is that it advocates falsehood precisely where truth is not only desirable from a utilitarian standpoint, but demanded from a moral standpoint. . . . [R]ules of law should reflect the community sense of acceptable conduct.").

248. In Dan-Cohen's words, the rule of law requires that "laws be clearly stated and publicly proclaimed." Dan-Cohen, *supra* note 37, at 667. Dan-Cohen's conception of the rule of law closely follows Raz's. See J. RAZ, *supra* note 82, ch. 11; Dan-Cohen, *supra* note 37, at 667 n.114.

249. See Dan-Cohen, *supra* note 37, at 667-73.

250. See *id.* at 665-67.

251. Dan-Cohen proposed that the requirement of clear and open laws serves four objectives: to limit officials' discretion, to enable law to govern citizens (an "instrumental" function), to assist citizens in rational calculation (a "utilitarian" function), and to protect individual liberty and autonomy. Dan-Cohen, *supra* note 37, at 668-71.

Dan-Cohen had no difficulty reconciling selective transmission with the instrumental and utilitarian objectives of the rule of law, because both are satisfied so long as conduct rules are clear and public. See *id.* at 668-69. He also concluded that official decisions can be sufficiently controlled by means of decision rules addressed to the decisionmaker, without the need for publicity. See *id.* at 668. This conclusion might be accurate in a world of perfect acoustic separation, but it is less persuasive in the case of real, partial acoustic separation. If the decision rule is obscure, officials may not apply it consistently. Further, in a formal version of selective transmission, decision "rules" may be open-ended standards that promote particularistic decisionmaking at the expense of restraint. Nevertheless, I will assume that decision rules have a determinate enough content and are sufficiently open to reason and debate at the point of application to fulfill the restraining function of the rule of law. Cf. Fuller, *The Forms and Limits of Adjudication*, 92 HARV. L. REV. 353, 372-82 (1978) (nature and requirements of adjudication according to the rule of law).

chosen ends.²⁵² Hidden decision rules frustrate this function of law.²⁵³

Dan-Cohen had several answers to this objection, in the context he considered. The example he worked from was a criminal conduct rule modified by a more lenient, acoustically separate decision rule. He noted first that a defendant who is excused by a lenient decision rule has no cause to complain.²⁵⁴ But this does not end the inquiry, because the defendant is not the only person affected: a discrepancy between conduct and decision rules also affects potential defendants who are deterred by the conduct rule. But in Dan-Cohen's view, the choice denied them—to violate the law without sanction—is outside the sphere of morally protected autonomy, because it is not a choice according to moral duty.²⁵⁵

I do not think the impact on autonomy can be explained away so easily, unless one takes a strict view of moral duty to obey law. In any case of selective transmission, the law that citizens see is imperfect.²⁵⁶ It omits a set of values that may have moral importance, but have been relegated for consequential reasons to a hidden decision rule. If we are morally bound to obey law, as law, then perhaps there is no conflict between selective transmission and autonomy. But if moral duty is not coextensive with legal duty, selective transmission will sometimes infringe on the autonomy of those who are deterred by a conduct rule.²⁵⁷ On the other hand, the damage to autonomy is closely circumscribed; it affects only the range of action between conduct and decision rules.²⁵⁸

With respect to liberty, Dan-Cohen conceded that selective transmission restricts freedom of action, by threatening a sanction that may not be imposed.²⁵⁹ His response was that overall, selective transmission has a positive effect on freedom of action, because it avoids the choice between a stricter decision rule or a conduct rule that offers less protection against interference by others.²⁶⁰ This ar-

252. See Dan-Cohen, *supra* note 37, at 670; J. RAZ, *supra* note 82, at 220-23.

253. See Dan-Cohen, *supra* note 37, at 670.

254. See *id.* at 671.

255. See *id.* at 671 (referring to autonomy "in the Kantian sense").

256. I think this is what Dean Singer has in mind when he refers to a "sterile positivist position." See Singer, *supra* note 222, at 99.

257. For review and analysis of different conceptions of the duty to obey law, see Powers, *supra* note 82.

258. Any legal rule that is a rule—in other words, any general rule that is overinclusive in application—has a similar impact on autonomy. I am grateful to Professor Larry Alexander for pointing this out.

259. See Dan-Cohen, *supra* note 37, at 672.

260. See *id.*

gument assumes, however, that liberty is fungible. It may be that the benefits of selective transmission justify a certain loss of liberty to those who are deterred by conduct rules, but they do not cancel it out. It is still a cost to be considered.

When selective transmission is introduced to contract enforcement, its relation to autonomy and liberty becomes more complex. To give the problem shape, assume that a promisor and promisee have agreed to a sale of land. The promisee has acted in good faith, but due to a mistake or changed circumstances, the promisor will suffer a severe hardship if the bargain is enforced. The governing conduct rule provides that promises are enforced in the absence of fraud or mutual mistake. The decision rule provides that promises will not be fully enforced in a case like this; the court will deny specific performance and damages will not duplicate the promisee's lost bargain. To make the case easier, assume also that the court can compensate the promisee for out-of-pocket losses.²⁶¹

Conduct rules have a special role in this setting. The main function of criminal conduct rules is to impose duties—to define and deter undesirable conduct.²⁶² Contract rules have a second function, which is to confer power on private parties to create rights and duties between themselves.²⁶³ In the terminology of Professor H.L.A. Hart, they are secondary rules.²⁶⁴

More accurately, a rule of contract enforcement has two aspects. First, it tells promisors to keep their promises. In this role, it is a primary (duty-imposing) rule. Second, it tells both promisor and promisee that if they have followed the rules of contract formation, the promisee's expectations will be enforced. In this aspect, it is a secondary (power-conferring) rule.

When a rule of contract enforcement is viewed as a primary rule directing promisors to honor their promises, the impact of selective transmission on autonomy and liberty is much the same as it is in

261. Courts may take this into account in deciding whether to allow an equitable defense. See *Panco v. Rogers*, 19 N.J. Super. 12, 16, 87 A.2d 770, 774 (Ch. Div. 1952).

262. Dan-Cohen, *supra* note 37, at 649.

263. H.L.A. HART, *supra* note 228, chs. 3 & 5.

264. Professor Hart's taxonomy of rules, and his explanation of the place of primary and secondary rules in a legal system, is set out in H.L.A. HART, *id.* Another discussion of the role of legal rules in establishing social "practices" is set out in Rawls, *supra* note 228. Rawls characterized the system of criminal punishment as a "practice," in which rules serve to confer and define powers, but his focus was on criminal decision rules rather than conduct rules. See *id.* at 30-31. See also P. ATIYAH, PROMISES, *supra* note 28, at 106-22 (questioning whether contract rules have a significant "constitutive" role); J. RAZ, *supra* note 213, at 156-66 ("P-laws").

criminal law. There will be a certain, limited loss of liberty and autonomy to those who perform their promises when they might have found refuge in an equitable defense.

When the rule is viewed as a secondary rule that sets the stage for private ordering, the impact of selective transmission changes. Most important, selective transmission affects promisees, by defeating their expectation that private arrangements will be backed by legal sanctions. In some cases, the promisee has violated background norms. For example, she may have taken knowing advantage of an unsophisticated promisor. If so, she cannot complain. But there are other situations—such as a unilateral mistake or a dramatic change in circumstances—in which the promisee is blameless.

In this case, there is no way around the conclusion that an obscure decision rule interferes with both liberty and autonomy. The legal system first invited the promisee to engage in the practice of contracting, then frustrated her expectation of enforcement. The effect of selective transmission cannot be discounted on grounds of moral or legal duty, because the conduct rules the promisee followed were powers, available for individuals to use at their option. If the whole law were clear, the promisee might have made another choice. As a result, her interest in autonomy and freedom of action is much harder to dismiss than the interest of someone who is moved by a false threat of sanction to comply with a primary rule.

On the other hand, the argument that the sum of liberty will be increased by selective transmission is especially strong in contract enforcement. A rule of strict enforcement enlarges the power that contract law confers on private parties. But without selective transmission of lenient defenses, the impulse of judges to do justice in particular cases would erode the rule and the benefit it provides for pursuit of individual and social ends.

I am not happy with the idea of acoustic separation. It points out the ways in which individuals fail at self-government and the need for centralized rules to govern them. It infringes on liberty and autonomy, particularly in contract law, where conduct rules are power-conferring rules, and there is no violation of duty in declining to follow them. On the other hand, effective social ordering requires some disregard of individual autonomy. Therefore, at least with respect to the economic interests at stake in contract law, I am willing to accept some deception in the application of law.

Even for those who believe selective transmission has no place in our legal system, the concept of acoustic separation is useful for the insight it provides into contract law. It shows that courts may

pursue two different ends through legal rules— regulation of conduct and regulation of decisions. And the relation of these two ends to traditional legal and equitable models of contract enforcement helps to clarify the choices involved in adopting and interpreting the defense of unconscionability. When a court accepts the unconscionability defense without reservation, it is focusing on individual decisions rather than general regulation of conduct. If it narrows and defines the defense, making it more rule-like, its attention is on conduct rather than decisions.

CONCLUSION

Equitable defenses to specific performance reflect formal and substantive values that differ from the values associated with traditional legal defenses. Yet there is no modern reason to associate one set of values with equitable remedies and one with legal remedies. This Article has considered several alternative explanations.

In some instances there are differences between specific and substitutional relief that call for a special defense to specific performance. This explanation is persuasive as far as it goes, but it applies only to a limited field of cases. It does not support the general proposition that contract defenses should be more lenient when the promisee seeks equitable relief.

In other cases, specific performance is not appropriate because there is no strong reason to protect the promisee's expectation interest in the contract. Here, the equitable fairness defense should be replaced with a revised view of contract enforcement. There are cases in which it is appropriate to protect against reliance loss, but not to give an expectancy remedy of any kind, specific or substitutional. Rather than relying on equitable defenses as a rough compromise, courts should define the sphere of contracts in which protection of reliance interests is the proper remedial goal.

The most difficult question is how the legal system should respond to the different values represented by legal and equitable defenses to contract enforcement. In current law, the equitable model of enforcement may be gaining ground. In particular, the unconscionability provisions of the UCC and the second *Restatement of Contracts* have expanded legal defenses and chosen a standard in favor of rules.

The concept of acoustic separation illustrates the formal and substantive relation of the two traditional models of enforcement to regulation of conduct and regulation of decisions. One emphasizes social ordering, another emphasizes individual justice. Equitable

defenses permit courts to pursue both ends, because they operate in a condition of partial acoustic separation. This arrangement may or may not be legitimate, but it does shed light on the choices presented by a legal defense of unconscionability.